Alberta Legislature

Annual Report of the Auditor General 1994 - 95

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Alberta Legislature

Office of the Auditor General

Mr. R. Hierath, MLA
Chairman
Standing Committee on
Legislative Offices

I have the honour to transmit herewith my Report to the Legislative Assembly for the fiscal year ended March 31, 1995, to be laid before the Legislative Assembly in accordance with the requirements of section 19(4) of the Auditor General Act.

Peter Valentine

FCA
Auditor General

Edmonton, Alberta
October 16, 1995

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Report For The Year Ended March 31, 1995

This report is issued pursuant to section 19 of the Auditor General Act. It is my first annual report to the Legislative Assembly and the seventeenth such report issued by the Auditor General of Alberta.

The report is for the year ended March 31, 1995. Some of the observations and recommendations it contains resulted from audit work carried out subsequent to that date.

Auditor General Act

The Auditor General Act requires that I perform financial audits to provide assurance that financial statements are fairly presented. In addition to adding credibility to financial statements, the Auditor General Act requires me to identify systems that could be improved. This report contains recommendations which I believe will help the government improve the financial administration of the Province.

Scope of work

Section 2 contains the results of my audit of the government's financial involvement in the Swan Hills special waste treatment facility.

The scope and extent of other audit work completed for 1994-95 and recommended improvements for the specific financial and management control systems examined by my Office are described in section 3 of this report.

For every financial statement audited, the Auditor General has issued an Auditor's Report. Section 4 contains information on those auditor's reports that contained reservations or reported a lack of compliance with legislation.

I am satisfied that those transactions and activities examined in financial statement audits complied in all significant respects with relevant legislative authorities, apart from the instances of non-compliance described in this report. I must caution that it would be inappropriate to draw a legislative compliance conclusion about matters not examined.

Improving The Financial Administration Of The Province

Introduction

On March 1, 1995, I joined a group of professionals committed to solutions in the public sector. The staff of the Office went out of their way to ensure that my transition from that of a senior partner in a major international accounting and auditing professional service

firm to the head of a legislative audit office went very smoothly. I thank them all and in particular want to commend Andrew Wingate, who was the Province's Acting Auditor General for a period of eleven months while the position was vacant. His wise counsel both within the Office and to our clients is much sought after, and I am fortunate to have him at my right hand.

I am challenged by the professional opportunities that exist in the Alberta Legislature Audit Office. This, my first report, represents both the culmination of a body of work, some of which has been "in progress" for over a year and the efforts of all of the personnel of the Office. They can be very proud of their professional efforts.

Accountability

Before the Members of the Legislative Assembly adjourned their spring sitting in May, they enacted what I believe to be a notable piece of legislation—the Government Accountability Act. It is notable for at least three reasons: it is at the forefront of such legislation anywhere in the world; it was supported by Members of the Official Opposition; and it presents a real challenge to turn the theory of public sector accountability into reality. In my opinion, the taxpayers of Alberta should applaud the government for bringing forward this legislation, the essence of which is captured in the words of the Honourable Member for Edmonton-Whitemud who said: "...this Bill will serve its purpose if people start thinking in terms of what government provides, in terms of the outcomes provided by government as opposed to looking at what is spent." My Office's further contribution to helping the government improve measuring and reporting the planned and actual cost and effect of its services can be found in recommendations throughout this report, but particularly in the recommendations numbered 1 to 6.

Our message is that performance measures are the links in the accountability chain, and in most situations a few simple measures of performance can tell a great deal about the economy and effectiveness of a particular program. Measuring cost and effect is the key to reducing costs and increasing effectiveness.

The evolution of full costing and the measuring and reporting of performance is progressing with the development of supporting systems. As more and more managers experience first-hand the direct correlation between measuring and improving performance, I am confident that the motivation of reporting success will stimulate further progress in understanding the cost and effect of outputs.

Consolidated statements

For the second year in a row, the government issued the consolidated financial statements of the Province within three months of the year end. Coming from the private sector, I can say that this is an exceptional achievement by those with the

responsibility for statement preparation. My staff's audit planning and execution to meet both our professional obligations within this time frame and the expectation of the client is also worthy of notice.

The speed with which the consolidated statements were issued is matched by their quality. My review of these statements made it clear to me that Alberta has taken a lead in developing progressive accounting policies and financial statement disclosure. As an auditor, I can say that it truly is an incentive to work in an environment in which the client wants to excel.

Annual report

The first annual report by the Government of Alberta, entitled *Measuring Up* (June 1995), was issued at the same time as the consolidated financial statements.

As requested by the Provincial Treasurer, I performed certain auditing procedures. The procedures did not constitute an audit and I expressed no opinion on the set of core measures included in *Measuring Up* (June 1995). I was, however, able to agree information back to its source, test calculations which converted source information into reported measures, and assess the appropriateness of the methodology descriptions.

As the systems, audit evidence and methods of obtaining assurance improve, the nature of my auditing procedures will change to enable the expression of audit assurance on this important information.

Adding assurance

In learning of the work of the Auditor General's Office, I was particularly struck by the concerted effort to promote the inclusion of supplementary performance information in financial statements. The issue is whether non-traditional performance reporting can be provided in financial statements and whether the standard audit report can be extended to cover certain, if not all, additional performance information.

Having reviewed our thinking on the issue, I do believe that the route to improving public sector financial statements in meeting users' needs lies in directly supplementing what is already in financial statements. Others see the solution in additional and separate reports.

On page 55, I have expressed my preference for performance measures to be included in financial statements so that users can find credible performance information in one place. Also, I communicated this belief to the Provincial Treasurer in my report on the core measures in *Measuring Up* (June 1995).

I am encouraged that managers and auditors in the private sector are also beginning to conclude that the reporting of performance information should be broadened. One of the ten elements of business reporting advocated by the American Institute of Certified Public Accountants special committee on financial reporting is disclosure of "High-level operating data and performance measurements that management uses to manage the business."

Swan Hills

On August 15, 1995, I issued a news release to make it clear that public discussion and concerns caused me to examine the government's involvement in the Swan Hills special waste treatment facility.

In many ways, the Swan Hills facility has achieved its intended objectives. To date, more than 70,000 tonnes of hazardous wastes have been incinerated, and Alberta no longer has a PCB problem. However, in my view these benefits could have been achieved for less cost. As I explain in section 2, which deals with the Swan Hills facility, I am confident that many of the problems that resulted in excess costs would have been avoided if the government's current three-year business planning and standing policy committee review process had been in place from the commencement of the Swan Hills venture.

In other words, the government's current planning process is a quantum improvement over the system that it replaced. For this reason, I have made only two recommendations based on the lessons learned from the Swans Hills venture.

These recommendations, if implemented, would enhance the already improved planning process. In essence, we are recommending that the effect of changes to plans be quantified before implementation and the effect of downside risk in proposed projects be quantified and disclosed.

Governance

I believe strongly that effective governance will over time contribute to successful performance, although it will not guarantee it. And I am sure that poor governance leads to poor performance. Therefore, my interest in governance issues is not theoretical. As Auditor General, I will make it a point to comment when I observe opportunities to improve the governance of public resources.

By governance, I mean the way in which we choose to organize ourselves to make sound decisions about public resources and services. Thus governance includes the critical review activity of the Public Accounts Committee. I liken the government to a corporation in which the people of Alberta are the shareholders, public servants are managers with varying degrees of responsibility,

and elected officials are the board of directors. This model appears simple but is full of complex relationships which continue to evolve in both the public and private sectors.

Only last December, a Toronto Stock Exchange committee issued guidelines for improved corporate governance in Canada. In May 1995, the Canadian Institute of Chartered Accountants issued a draft of proposed guidance for directors on governance processes for control. Those of us in the public sector working to improve accountability can benefit from these initiatives. In fact, the decision to establish a board of directors for Alberta Treasury Branches is acknowledgement that effective governance requires that management assumptions be challenged by an independent group with complementary but distinct responsibilities.

From my perspective as Auditor General, a key board committee is the audit committee. Audit committees' responsibilities include reviewing the quarterly and annual financial statements and ensuring that management has implemented an effective system of internal control. Where I observe that audit committees should be in place and are not, or existing audit committees are not performing the appropriate functions, I will make appropriate recommendations.

Autonomy

I have some comments on the argument that so-called devolution of responsibility from central government leads to diminished accountability.

Exchanging autonomy for accountability is not an abstraction but rather the practical way to adapt the roles of all players in achieving value for public money. A primary role of government is to select, monitor, evaluate, and sometimes remove boards or managers. The extent to which ministers should cross the boundary into management is wholly dependent on the quality of boards and managers, and on government's ability to assess performance against performance goals.

A precondition for management successfully achieving goals is freedom to make the decisions necessary to operate efficiently. The means to that freedom is accountability in the form of business plans, budgets, and performance reports. The reality is that government does not have the same information and decision-making insight that full-time professional managers have when dealing with complex operating issues over an extended period of time. The extent of credible performance measures should determine the balance of the roles.

Rewarding performance

On page 55, I discuss rewarding performance, a subject not new to this Office's annual report. The previous two reports have expressed concern with the perpetuation of central salary control.

The problem is that the government continues to control centrally all government employee salaries without regard to performance. Program managers are handicapped because they cannot vary compensation as a management tool for improving efficiency.

I am genuinely concerned that not rewarding superior performance will cause long-term problems in attracting and retaining the people needed to reach the goal of, and sustain, affordable and effective government.

Office highlights

On December 6, 1994, the Office of the Auditor General held a staff planning seminar with the theme of "Improving Performance - Our Contribution." Speakers were: Hon. Jim Dinning, MLA, Provincial Treasurer; Muriel Abdurahman, MLA, Chairman of the Public Accounts Committee; Dr. Norman Wagner, Chairman of the Province's Audit Committee; and Andrew Wingate, Acting Auditor General. The speakers tackled the issue of performance measurement from their own experience and from the perspectives of their positions. I was pleased to be able to hear the speeches, all of which were challenging to someone about to enter public service. Later that day, I observed the planning discussions and learned about audit projects, the results of many of which are contained in this report.

I am pleased with the efforts of my Office to advise boards of regional health authorities on the issue of the appointment of auditors. The Regional Health Authorities Act requires that unless the Minister appoints the Auditor General as the auditor for the region, the region must appoint its auditor. The Capital, the Calgary Regional, and the Palliser Health Authorities each appointed me as their auditor and I issued an auditor's report on each of their combined financial statements at March 31, 1995. In doing so, I relied on the audit work of the auditors of the various health facilities in each region.

Increasingly, senior staff of the Office are being invited to serve on task forces created by our clients to study current issues. This expression of confidence is a real boost. In particular, I am pleased to note that we were represented on the Treasury Board task force that studied performance measures proposed for *Measuring Up* (June 1995).

Mention is made elsewhere in this report of the document published by the Office entitled *Government Accountability*. In it, we stress

our view that accountability is all about improving the economy and effectiveness of government operations. In addition to using the document as a discussion tool with clients, it was presented to the Public Accounts Committee with a request for comment. Although not an academic document, we submitted it for consideration by the Canadian Academic Accounting Association. We are pleased to report that it was selected for presentation at their annual conference in June 1995. The document was also presented at the annual Institute of Public Administrators of Canada conference in August 1995.

Turning from theory to practice, I want to conclude by saying that my staff and I are fortunate to be able to practice our profession—legislative auditing—in a Province in which the overwhelming majority of our clients have a genuine desire to improve their operations. For example, the new accountability arrangements for lottery operations described on page 57 will translate into considerable dollar savings through improved efficiency. As is invariably the case, improved accountability gives rise to improved economy and effectiveness.

Guidance For The Reader

Section 2

This section contains my findings and recommendations with respect to the government's financial involvement in the Swan Hills special waste treatment facility.

Section 3

Section 3 of the report describes the work of my Office for 1994-95 respecting audits of the various departments and agencies of the government. It contains the significant audit observations and recommendations that were reported to management as a result of that work. When determining significance, I consider the nature and materiality of the matter relative to the individual entity and the government as a whole.

This report contains 74 recommendations. These recommendations are provided for the benefit of Public Accounts Committee members, ministers, other MLAs and the public. **Of these 74 recommendations, the 38 recommendations that I consider particularly important and therefore warrant a formal government response are numbered and shown on a shaded background. Of the 38 recommendations, 10 are repeat recommendations.**

Section 4

Section 4 of the report describes our legislative mandate, our mission, and the reporting process. It contains a summary of the audit report reservations issued for 1994-95, discusses the audit of the Public Accounts and includes my report under section 18 of the Auditor General Act. It also includes an explanation of accounting principles and auditing standards in the public sector.

Section 5

Section 5 describes our operations.

Acknowledgements

Pursuant to section 19(1)(b) of the Auditor General Act, I am pleased to report that in carrying out the work of my Office I received all the information, reports and explanations that were required.

The co-operation extended to my staff by all of our clients in the last year has been excellent. People at all levels in our client organizations have made our work that much easier with their cordiality. Since joining the Office, I have met the senior management of many of our clients. I appreciate the frankness of the discussions we have had.

To my staff, I say thanks. I acknowledge publicly your professionalism, dedication and hard work.

I believe that readers will conclude that this report is a constructive contribution to improving Alberta's prosperity.

Peter Valentine
FCA
Auditor General

Edmonton, Alberta
October 14, 1995

INTRODUCTION

In a news release on August 15, 1995, I acknowledged a public perception that the government's involvement in the Swan Hills special waste treatment facility has not been successful. I concluded therefore that this involvement is an issue worthy of examination by my Office and comment in this report. The Auditor General is the auditor of the Alberta Special Waste Management Corporation (the Corporation), but is not the auditor of the Joint Venture which owns the Swan Hills facility.

To set the scene, I have chosen to provide a chronology of events, starting when consideration was first given to building a special waste treatment facility, and ending with the government's decision to dispose of its investment in the facility. While this chronology is intended to be a factual account of the key events that occurred, it focuses mainly on events that have attracted the most public comment. Where I believe it useful to do so, I have also provided commentary on some of those events. At the end of the report on Swan Hills, I have included a listing of the principal officials referred to in the text.

In July 1995, the government signed a letter of intent to ultimately sell to BOVAR Inc. the government's 40% interest in the joint venture that owns the Swan Hills facility. As a prerequisite to any sale, agreement must be reached limiting the Province's liabilities under the joint venture agreement. Since negotiations under the letter of intent are proceeding at this time, it is inappropriate for me to comment on the plan for disposal. I will consider doing so at a later date in a separate report.

SUMMARY AND COSTS

Summary

Early 1980s — The Government of Alberta decided that the Province needed a waste treatment system, part of which would be an integrated hazardous waste treatment facility.

July 1982 — The government announced that Chem-Security Limited had been selected to design and construct a hazardous waste facility. Chem-Security (Alberta) Limited (Chem-Security) eventually became the operator of the facility.

March 1984	The government announced that the facility would be located near the Town of Swan Hills, Alberta.
April 1984	Legislation came into force establishing a Provincial corporation called the Alberta Special Waste Management Corporation.
February 1987	The Corporation entered into a joint venture (the Joint Venture) with Bow Valley Resource Services Limited (BVRS - later to become BOVAR Inc.). The Joint Venture financed the construction of the Swan Hills facility, to be operated by Chem-Security, a subsidiary of BVRS.
September 1987	Following test burns and commissioning, the Swan Hills facility held its official opening ceremony.
May 1989	BVRS changed its name to BOVAR. Then in December 1989, Trimac Limited acquired 47% of the common shares of BOVAR.
May 1992	The Natural Resources Conservation Board (NRCB) approved, with Cabinet authorization, an expansion of the facility's rated incineration capacity by approximately 40,000 tonnes per year. (Note: throughput capacity is less than rated capacity).
April 1993	The Corporation and BOVAR signed an amended joint venture agreement.
October 1993	The major expansion of the facility was completed and test burns commenced thereafter.
November 1994	The NRCB approved the importation of hazardous wastes from other Canadian jurisdictions. Importation was approved by Cabinet in February 1995.
January 1995	Following the appointment of a new Board and President, the Corporation resolved to examine ways of divesting itself of its interest in the Joint Venture.

March 1995 — All the Corporation's community waste programs were transferred to the Department of Environmental Protection.

July 1995 — The Corporation, the Province and BOVAR signed a non-binding letter of intent to negotiate an agreement under which the Corporation's interest in the Joint Venture could be sold to BOVAR. Negotiations pursuant to the letter of intent are currently ongoing.

Costs

Some people have characterized the Swan Hills facility as a business venture, and its financial results as losses. I believe this is unfortunate because from the earliest days, most serious observers viewed the facility as a government program that was delivered in conjunction with a private sector partner.

The Environment Council of Alberta described the purpose of the program in 1980 when it reported that Alberta needed a system for handling hazardous wastes safely. The public safety theme is continued in the Special Waste Management Corporation Act where the Corporation's first objective is "to provide for the economical, orderly and efficient development and operation of a special waste management system to assist the Government in ensuring the protection of the environment and the health and safety of the public." In this context, I believe that "economical" means at a reasonable financial cost to the Province.

In many ways, the Swan Hills facility has achieved its intended program objectives. Alberta no longer has a PCB problem, a claim that few jurisdictions in North America can make with conviction. In addition, a facility exists where Alberta industries can dispose of their hazardous wastes without retaining any future liability. This is not the case in many other jurisdictions. In the United States, in particular, waste generators are unable to transfer liability for their hazardous wastes to the facilities that treat or dispose of them. Further, the facility has undoubtedly reduced significantly the health and environmental risks associated with the storage and spillage of hazardous wastes. To the present time, the facility has incinerated more than 70,000 tonnes of hazardous waste.

In my view, however, these benefits could have been achieved for less cost.

The following is a summary of costs incurred by the Alberta Special Waste Management Corporation in connection with the Swan Hills special waste treatment facility. Under the joint venture agreement with BVRS (now BOVAR), the Corporation pays the Joint Venture amounts sufficient to cover the Joint Venture's operating deficits and to provide BOVAR with a guaranteed return on its investment:

	Total Operating Deficit	BOVAR's Guaranteed Return (in thousands)	Total Cost
Year ended March 31 - 1987	$ 1,470	$ 789	$ 2,259
1988	12,740	3,467	16,207
1989	14,064	7,579	21,643
1990	18,033	9,486	27,519
1991	21,608	8,703	30,311
1992	19,735	6,349	26,084
1993	19,061	5,585	24,646
1994	18,822	4,882	23,704
1995	22,487	15,713	38,200
	$ 148,020	$62,553	210,573
April 1, 1995 to June 30, 1995			9,621
Total contribution to June 30, 1995			220,194
Write-off of the Corporation's investment in the Joint Venture and related infrastructure			49,889
Proportion of the Corporation's activities and administration costs related to the Joint Venture for the period from 1986 to March 31, 1996			23,370
			293,453
Payment to BOVAR assuming that the disposal of the Corporation's investment in the Joint Venture, occurs as envisaged in the July 1995 letter of intent			147,500
Total cost (but see following paragraph)			$ 440,953

The above figures do not include interest on any government borrowings to finance costs associated with the Joint Venture. Furthermore, figures are not available on the costs incurred prior to 1985 by the Department of the Environment and the Environment

Council of Alberta in determining the type of waste treatment system Alberta needed and an appropriate site for the facility. The above figures also do not include the cost of remediating the site when the Swan Hills facility eventually closes. As disclosed in the Corporation's 1994-95 financial statements, an independent consultant tested the amount of contamination of the plant site in March 1995. The consultant's preliminary report indicated that the estimated cost of decontaminating the area tested is approximately $100,000. The consultant further estimated that the cost of decommissioning the plant could range from $31 million to $57 million. An amount of $42 million is considered a reasonable estimate of the decommissioning cost, representing the mid point of the range after deducting the plant's estimated salvage value. Because the assumptions used in the estimates can change, as can the amount of decontamination or the decommissioning methods used, these costs could decrease or increase by a material amount.

A number of factors contributed to the Joint Venture's operating deficits each year. For example, for social and environmental reasons the facility is required to treat all types of hazardous waste (except for radioactive, bio-medical waste and explosive material) thus preventing it from specializing in wastes that are easier and most profitable to treat. In addition, the facility incinerated its waste to higher standards (99.999999% destruction) than those of its competitors, yet it was not allowed to charge more than its competitors.

Prior to the major expansion, throughput capacity was insufficient to generate enough revenue to cover operating cost. The high capital cost of the facility and resultant amortization charges contributed to high operating costs. Following the major expansion, idle capacity and increased amortization costs have further contributed to operating deficits. The facility's financial results were also adversely affected by the growing use of certain wastes as fuel for cement kilns, which in recent years has generally depressed waste disposal industry revenues.

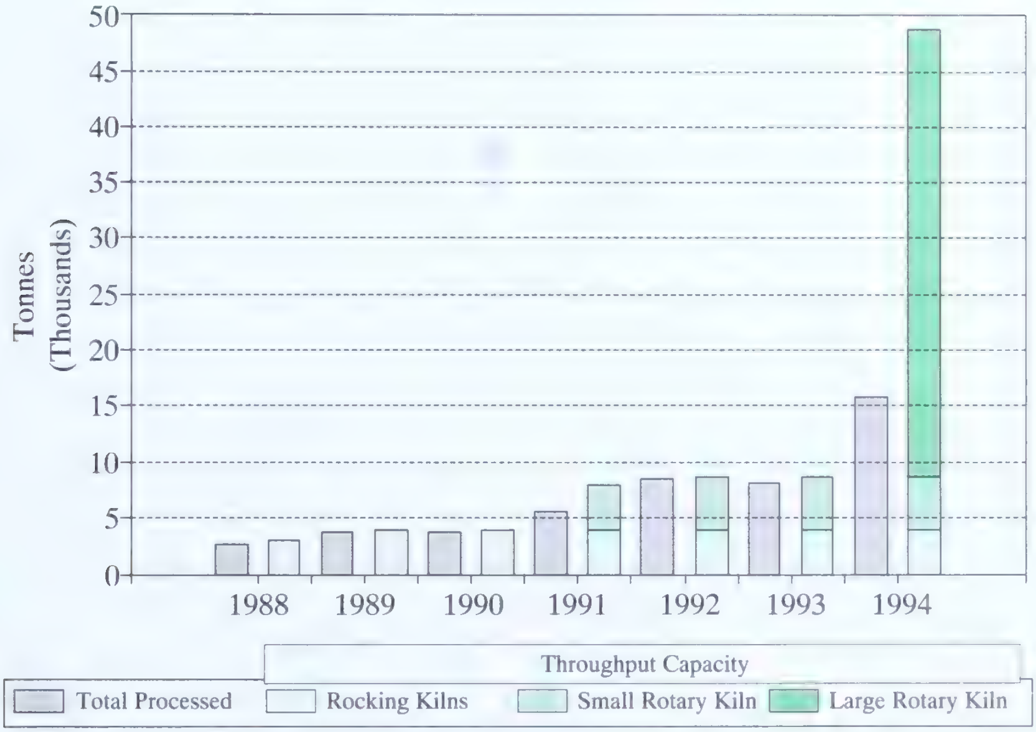
Alberta Special Waste Management System Joint Venture

Selected Information Based on December Year-Ends
(in thousands)

	1986	1987	1988	1989	1990	1991	1992	1993	1994
Annual:									
Tonnes incinerated per Chem-Security	n/a	n/a	2.6	3.7	3.7	5.6	8.4	8.0	15.7
Revenues from waste generators	$ 237	$ 1,093	$ 3,317	$ 3,564	$ 3,043	$ 9,316	$11,877	$ 14,317	$ 32,788
Operating costs (excluding amortization)	296	9,330	13,250	14,056	17,847	22,191	23,344	22,693	33,647
Amortization	100	2,599	5,165	5,469	6,369	7,515	8,023	8,863	15,365
Year end:									
Net book value of capital assets	26,650	48,200	46,455	51,696	59,038	61,389	74,720	142,113	148,679

Waste Treatment - Incineration

(per Chem Security (Alberta) Ltd.)



Note: The amounts processed are on a calendar year basis and do not include the volumes processed by the physical/chemical facility and the stabilization plant. Throughput capacities are based on the historical mixes processed and assume a constant mix of liquid/solid waste. The rocking kilns were not operated after September 1993.

Guidance To Reader

In my view, the cost of the government's financial involvement in the Swan Hills special waste treatment facility would have been less but for the following two strategic mistakes:

- the terms of the joint venture agreements between the Corporation and BVRS/BOVAR, and
- the decision to proceed with a major expansion of the Swan Hills facility in 1992 without first ensuring that the regulatory requirements necessary to obtain the facility's forecasted waste streams were in place, and that the capital costs to be incurred would be consistent with the future economic operation of the facility.

The remainder of this report on Swan Hills is arranged under the following section headings:

- The joint venture agreements
- The major expansion of the Swan Hills facility

Each section outlines the key events, and contains narrative on the strategic decisions made, together with my findings, conclusions and recommendations.

THE JOINT VENTURE AGREEMENTS

PAGE

Key events

January 1980	The Hazardous Waste Management Committee, formed by the Minister of the Environment in September 1979, recommended that the Province begin immediately to implement a system to manage and treat hazardous waste.
July 1982	Following an international competition, the government announced that Chem-Security Limited had been chosen to design and construct an integrated special waste treatment facility.
March 1984	The government selected the Town of Swan Hills as the site for the waste treatment facility.
April 1984	The Special Waste Management Corporation Act came into force, following which the Corporation's Board assumed responsibility for negotiating an agreement with Chem-Security.
December 1984	Chem-Security became a wholly-owned subsidiary of BVRS.
June 1985	Site preparation and construction began at Swan Hills following the signing of a February 1985 interim agreement between the Corporation, BVRS and Chem-Security.
December 1985	When negotiations between the Corporation and BVRS on a final agreement stalled, the Minister of the Environment changed the Corporation's Chairman.
March 1986	Agreement was reached on the principles for a proposed joint venture agreement between the Corporation and BVRS.
February 1987	The joint venture agreement between the Corporation and BVRS was signed.
September 1987	Following test burns and commissioning, the Swan Hills facility held its official opening ceremony.
May 1992	The Natural Resources Conservation Board approved, with Cabinet authorization, an expansion of the Swan Hills facility's incineration capacity.
July 1992	The Corporation and BOVAR began to negotiate an amended joint venture agreement.
April 1993	The Corporation and BOVAR signed the amended joint venture agreement.

Background

The dumping of hazardous wastes was of growing public concern in North America during the 1970s. The serious contamination of the Love Canal in New York State was one of many stories that attracted extensive media comment. Here in Alberta, public awareness was raised during 1979 when a company applied to build a hazardous waste treatment facility in Fort Saskatchewan. The ensuing efforts of a citizens' action group to oppose the application attracted much publicity. These events, plus growing anxiety about PCBs, sparked widespread public concern about the hazardous wastes being generated and stored in Alberta.

It was against this backdrop that in September 1979, Alberta placed a moratorium on the development of waste disposal facilities. In the same month, the Minister of the Environment formed a Hazardous Waste Management Committee to advise on ways of dealing with hazardous wastes, the type and location of waste facilities required, and the ownership and financing of such facilities.

In January 1980, the Committee recommended that the Province develop an integrated system to manage hazardous waste, take a lead role in developing legislation and, if necessary, operate waste management facilities. The Committee also concluded that Alberta was generating insufficient waste to support a large waste treatment facility, and that the government would need to provide financial support and regulatory definition.

Thereafter, the Environment Council of Alberta commissioned consultants' reports on the transportation risks, health concerns and legal and regulatory aspects of operating hazardous waste treatment facilities. The Environment Council also held information meetings or public hearings in 25 centres across the Province. In December 1980, the Council reported broad agreement among industrialists and the public that Alberta needed a system for handling hazardous wastes safely.

Choosing a site for the facility

Following extensive public participation, a site for the facility was chosen. The main selection criteria were public and environmental acceptability, with the former being pre-eminent. Efforts were made to provide information to the public about hazardous waste treatment, and applications were invited from communities interested in having a waste treatment facility.

Many communities showed initial interest but, by late 1982, the number still interested had been reduced to three. In plebiscites held

shortly thereafter the citizens of two communities, being the Town of Swan Hills and the Village of Ryley, voted strongly in favour of having a waste treatment facility. In March 1984, the Cabinet selected Swan Hills as the site for the hazardous waste facility.

Choosing the technology and a private sector proponent

During 1980 and 1981, the government explored various technology options. Consultants' reports were obtained and treatment facilities were visited in Europe and the United States. At this time, the public seemed more interested in siting and safety than in technology issues; recycling and incineration were deemed the most popular options, and landfills the least popular.

In 1980, the Hazardous Waste Management Committee had recommended an integrated waste treatment facility. An integrated facility is one capable of handling most types of waste, as opposed to a dedicated facility which enjoys the economic advantage of specializing in only certain types of waste. At that time, there were no integrated facilities operating in North America, though there were several in Europe.

The Environment Council had concluded that the public generally would prefer hazardous waste treatment facilities to be administered by a Crown agency, perhaps with private business involvement. Many private business interests also seemed to favour a business/government partnership, with government owning the land, and regulating and perhaps subsidizing the system.

In January 1982, the government issued a "Request for Proposal" for the construction and operation of an integrated waste treatment facility in north central Alberta. It is noteworthy that the Request for Proposal advised proponents to obtain their own forecasts of waste volumes that were likely to be available for treatment in Alberta. The Request for Proposal also warned that the government would continue to encourage generators to treat their own wastes on-site.

The Request for Proposal specified various components and technical requirements for the facility, including high temperature incineration. The successful applicant was expected to assume full responsibility for developing, operating and financing the facility. Applicants were also asked to provide information that could be used to assess the viability of their financial plans.

Following an international competition, 19 proposals were received. A technical review committee short-listed four applicants and invited them to make detailed presentations. The committee's

recommendation was unanimous and in July 1982, the government announced that Chem-Security had been chosen to design and construct the facility.

It appears that Chem-Security was selected mainly on the merits of its technical submission. Although Chem-Security had no experience with hazardous waste incineration, it had connections with a company in Europe which had expertise with incineration kilns. Chem-Security also indicated a willingness to finance the facility, but required government undertakings that available waste volumes would be sufficient to provide a reasonable return on its investment. In its application, Chem-Security estimated the capital cost of a facility capable of treating 30,000 tonnes per year at $47 million.

Estimates of hazardous waste volumes available for treatment

Estimating the types and volumes of hazardous waste that Alberta industries generate, and will generate in the future, has always been difficult. There are many reasons for this. For example, many waste generators are understandably reluctant to release details of the hazardous waste they produce or intend to produce. Economic and technological changes can also reduce the future generation of waste. Regulatory changes can have a huge impact on the waste to be treated by expanding or contracting hazardous waste definitions, or by legislating different treatment processes.

Estimating the waste that a treatment facility will receive is further complicated because waste treatment facilities typically attract only a portion of the waste that is generated. This is because waste generators have other options for dealing with their hazardous waste. Depending on the nature of the waste and the regulatory environment, they can store it, treat it themselves, deepwell inject it, recycle it, or take steps to minimize the amount of waste they generate. In recent years, some wastes have even been saleable as fuels.

It is not surprising, therefore, that forecasting demand for treatment at the Swan Hills facility has been consistently difficult.

Plant design and construction

Chem-Security's 1982 response to the Request for Proposal suggested a $47 million facility with an annual capacity of 30,000 tonnes, of which 12,500 tonnes was to be incineration.

It should be noted that the rated capacity of an incinerator is a manufacturer's estimate of the tonnes of waste that it can process.

Chem-Security officials have informed me that because of the mix of waste received at Swan Hills, the incinerators often process significantly less than their rated capacities.

Site preparation and construction at Swan Hills began in June 1985. The project was "fast tracked" and no definitive price estimate was obtained. The main contractor was remunerated on a cost-plus fixed fee basis. Correspondence from the project manager indicates that obtaining a definitive estimate and a firm price from the main contractor was discussed with Chem-Security. It was decided, however, that fast tracking would save time and money.

In November 1985, Chem-Security presented a new capital cost estimate of $47.6 million, which was approved by the Corporation at a Board meeting in January 1986.

The final capital cost of the original Swan Hills facility was a little over $54 million. The facility comprised two incineration kilns, a physical/chemical facility and a stabilization plant. Based on the mix of waste received in 1989, the three facilities processed 3,700, 105, and 543 tonnes of waste respectively.

Negotiating the original joint venture agreement

In July 1982, Chem-Security was selected to design and construct the facility. Following this, four and a half years of negotiations were needed before the joint venture agreement was eventually signed.

From the beginning, negotiations between Chem-Security and the Province were arduous. In 1982, Chem-Security was acquired by a United States corporation with an alleged history of regulatory violations. This issue hampered, and at one time suspended negotiations. It was not fully resolved until December 1984 when Chem-Security was acquired by and became a wholly-owned subsidiary of BVRS.

In December 1984, the Alberta Special Waste Management Corporation and Chem-Security signed a Memorandum of Intent which defined their roles and responsibilities. The capital cost of the facility was to be borne by Chem-Security, with the Corporation bearing the capital cost of providing roads and utilities to the site. In the same month, the Corporation and BVRS signed a Letter of Undertaking setting out a general framework of terms and conditions to be negotiated. BVRS was to receive a rate of return on its investment of between prime plus 4% and prime plus 9.5%, and accept the down-side risk on waste volumes and a ceiling on net

income. It was further agreed that BVRS' equity capital in the facility would represent 80% to 100% of the total capital required.

In February 1985, the Corporation, Chem-Security and BVRS signed an Interim Agreement which, while anticipating a delay in negotiating a final agreement, enabled construction to begin at Swan Hills.

Even with this agreement in place, negotiations did not proceed smoothly. The Corporation's Board and BVRS/Chem-Security consistently disagreed on such issues as roles and responsibilities, assumption of risk and liability, and appropriate rates of return on investment. Complicating negotiations was the lack of reliable information about the nature and volume of wastes that would be available. There was debate at this time about the extent to which the Swan Hills facility could or should operate like a regulated utility.

In October 1985, Chem-Security indicated that raising the necessary financing within the BVRS group would be difficult, and that more debt-financing would be involved. Later Corporation Board minutes indicate that BVRS wanted a payback on its investment over a period of five or six years. Some Corporation Board members expressed concern about the continued financial health of BVRS and whether it would survive.

Corporation Board minutes indicate that by October 1985, the Board was divided on several issues. There was division on whether the Corporation's responsibility was to make a deal with Chem-Security without further delay, or to hold out for a business agreement in the best interests of Alberta taxpayers. Some Board members expressed concern that the facility might never be commercially viable unless waste could be imported from other provinces.

There were also discussions about how much Alberta taxpayers should be expected to pay to keep the facility in the private sector, and whether there were other alternatives for private sector involvement to those currently being discussed with Chem-Security. The Corporation's Chairman believed that there were less costly private sector alternatives (including a regulated utility), which would accomplish the objective of private sector ownership and operation. The minutes indicate that the Board decided to seek direction on these issues from a Cabinet Sub-Committee.

In November 1985, at the Corporation's request, Cabinet gave approval for the Corporation to negotiate a Joint Venture with BVRS to own the facility, with BVRS holding the majority share. Each party presented the other with proposed joint venture agreement

terms, but both found the other's position unacceptable. BVRS threatened to cease construction at Swan Hills if agreement was not reached by the end of the year. The Corporation's Board passed a resolution that if BVRS did not accept the Corporation's final offer, the Crown should assume responsibility for completing construction, attempt to reach a management agreement with BVRS to operate a Crown-owned facility and, failing that, seek a new private sector operator.

Also in November 1985, the Corporation received a report it had commissioned from consultants Woods Gordon. The report concluded that the Crown had "...put forward its best offer to CSL/BVRS. This offer has been rejected and a counter offer has been put forward. The Crown's offer reflected some protection against volatility of increases in prime interest rates but provides little protection against revenue and cost volatility. Although the Crown's position is supportable given the corporation's mandate, we do not think it is the most prudent financial or business decision from the Crown's point of view. Given that the project is not presently seen to be economical using the current estimated costs and revenues, it does not appear 'practical' to establish this project in the private sector at this time. However, as the legislation states that private sector involvement is desirable, we recommend that the Crown consider negotiating a private sector management contract to operate a Crown owned facility. If, in time, the revenues and costs appear to render the project financially economical, it would then be appropriate to seek a transfer of the assets and responsibility to the private sector." The Report also noted that under the alternatives analyzed, changes in the volumes, costs, interest rates and prices, would not "...impact the net cashflows to CSL/BVRS to any extent. Therefore virtually all risk of inaccurate estimation and unforeseen long term events rest with the Crown."

After considering the consultant's report, the Board met with the Cabinet Sub-Committee to review the status of negotiations and to obtain advice. The Board received instructions which it interpreted as authority to negotiate "up to" BVRS' position. Despite this, however, the Board decided to reaffirm its own final offer and, on December 13, 1985, notified BVRS by letter that it was unable to accept BVRS' final offer, and was seeking direction from the Minister.

On December 16, 1985, the Corporation's Chairman informed the Minister of the Environment that the Board had approved the steps necessary to proceed with its own recommended course of action. This was that Chem-Security would be paid out under the terms of the Interim Agreement, and a new owner and/or operator would be sought unless an operating agreement could be negotiated with

BVRS/Chem-Security. Within days of receiving the Chairman's letter, the Minister terminated the Chairman's contract, and two Board members resigned in support of the former Chairman. A new Chairman was appointed, the Board members were replaced, and negotiations resumed.

The new Chairman has told me that he believed his first priority was to reach an agreement with BVRS that was acceptable to the government, without further delay. This would enable the Swan Hills facility to be completed and ease public concern about accumulations of hazardous waste.

In March 1986, the government agreed to the principles for a joint venture agreement between the Corporation and BVRS. In a Ministerial Statement issued in March 1986, the Minister of the Environment outlined the terms and conditions of the proposed joint venture agreement.

At a news conference on the same day, the Minister stated that BVRS was to receive a guaranteed rate of return because of the uncertainties about volumes, market prices and costs. He also stated that "we do believe this will be a profitable venture" and that "there will be an independent third party review board on June 30, 1989 - that I believe gives us all the protection we need in terms of the rate of return and the financial arrangements...I think that provides us with the protection that we require in this agreement and it resolves any concerns of Woods Gordon or any of those concerns in my judgement. ...I think we have come up with an approach which will see this project proceed [and will] see the special waste problem [in the] Province resolved." The Minister acknowledged, however, that if volumes were low or if treatment costs increased, the government would be required to contribute.

From the date that the proposed agreement was signed, negotiating the final agreement took almost a year. The "Joint Venture Agreement for the Construction, Ownership and Operation of a Part of the Alberta Special Waste Management System" was finally signed in February 1987. Commissioning tests for the incinerators at Swan Hills began in September 1987. The official opening ceremony was held the same month, and the facility was fully licensed in November 1988.

The original joint venture agreement

The joint venture agreement comprises over 70 pages of objectives, terms, conditions and definitions. The more important terms and conditions can be paraphrased as follows:

(a) The agreement provides for the ownership and operation of the Swan Hills facility, the safe disposal of special waste, and a "fair and equitable rate of return" to BVRS. Chem-Security is the operator of the Swan Hills facility.

(b) BVRS owns 60% and the Corporation owns 40% of the Joint Venture. BVRS and the Corporation contribute funding in this ratio to meet the Joint Venture's capital costs and working capital needs, and they share in its profits in the same ratio.

(c) The Joint Venture's Board has six members, three appointed by BVRS and three by the Corporation.

(d) BVRS is guaranteed a return on its investment in the Joint Venture's operating assets (the rate base). The after-tax return approximates the Royal Bank of Canada prime bank lending rate plus 3%. (Depending on the prime lending and taxation rates, the actual before-tax rate paid over the years has varied from 17% to 31% per year.) The guarantee means that if the Joint Venture operates at a loss, the Corporation pays the Joint Venture a contribution equal to the loss, plus the amount needed to provide BVRS with the guaranteed return on its investment.

(e) In June 1989, and each five years following the date the facility commenced full operations, the terms and conditions of the joint venture agreement are to be reviewed. If the joint venturers are unable to agree on amendments, the original joint venture agreement stands.

(f) The Joint Venture can be terminated by mutual agreement, or by either venturer materially breaching the agreement's terms or conditions. If the Corporation terminates, for reasons other than material breach by BVRS, BVRS can require the Corporation to purchase its investment at the greater of the "rate base price" and the "current fair value." If the Corporation terminates the agreement because of a material breach by BVRS, BVRS is entitled to the rate base price. The rate base price is approximately equivalent to the working capital and unamortized value of capital asset costs contributed by BVRS. The current fair value is the net present value of ten years forecast income (including Provincial contributions) of the Joint Venture, plus amortization and non-cash operating expenses. The current fair value would normally be much larger than the rate base price; for example, at December 1994 it was estimated to be two and a half times the rate base price.

BVRS can also terminate the joint venture agreement and require the Corporation to purchase its investments at the rate base price:

- if the June 1989 review results in government recommendations for change that are not acceptable to BVRS, and

- at any of the five year review dates.

The Corporation can terminate the joint venture agreement at any of the five year review dates only if it can demonstrate that the Corporation's future contributions to cover operating deficits and guaranteed return on investment will be unreasonably high and unlikely to decline over the next five years (section 1302). Such a termination would require the Corporation to purchase BVRS' investment at the rate base price.

(g) If BVRS defaults on its borrowing obligations with its banker, the Corporation can be required by BVRS' banker to purchase BVRS' share of the Joint Venture for the **greater** of the rate base price and the current fair value, regardless of the amount of BVRS' borrowing.

Negotiating the amended joint venture agreement

The original joint venture agreement provided for a review of its terms and conditions in June 1989, and every five years after the date the facility began operations. In December 1989, however, the Minister of the Environment deferred the first review until 1990, to allow time to gain experience about the facility's operational and financial results. The review was later deferred again until 1992. Negotiations between the Corporation and BOVAR began in July 1992, by which time the NRCB had approved the major expansion of the Swan Hills facility.

A "summary of the negotiations" prepared by the Corporation after the amended agreement was signed states that two matters significantly influenced the negotiations. The first was that "without resolution of the review, BOVAR was not in a position to obtain financing which it required to supply its portion of the expansion costs." And secondly, "the clear direction preferred by government was to renegotiate the arrangement with BOVAR, rather than effecting a buy-out at that time."

In June 1992, before negotiations began, the Corporation's President wrote to the Minister of the Environment outlining a negotiating

strategy. He expressed the view that BOVAR's investment was essentially risk-free, its payback and return on capital invested were guaranteed, and that termination arrangements all favoured BOVAR. He recommended a more appropriate sharing of the risks, a return on investment that reflected the risks shared, and a modified way of paying back capital. Alternatives such as buying out BOVAR, finding a new partner, or the Corporation itself operating the facility were also mentioned.

Early negotiations were difficult, and by September 1992 they had become very difficult. The Corporation's Board was of the view that without an appropriately amended agreement, it should seek to terminate the Joint Venture under section 1302 of the agreement because it was neither politically nor economically acceptable to continue to repay capital and pay a rate of return from public funds to a Joint Venture partner who was not sharing the financial risks.

The minutes of the Corporation's October 5, 1992 Board meeting indicate that the President advised the members that BOVAR was not prepared to proceed with the major expansion until an amended joint venture agreement was signed. The minutes also indicate that the Corporation's solicitor advised the meeting that section 1302 could probably be invoked successfully before the major expansion began, but that invoking it after that would be more difficult and costly. If the Corporation had been able to invoke section 1302 to purchase BOVAR's investment, the cost at that time would have been less than $40 million. After the expansion, however, the cost would have more than doubled.

The Board members agreed that the Minister should decide on the course of future negotiations with BOVAR. The minutes indicate that "The members then passed a resolution...directing the executive to negotiate a new amending agreement which better reflects the items of concern, delay construction until an appropriate amending or interim agreement is reached, direct the executive to approach the Lieutenant Governor in Council through the Minister for approval to invoke section 1302 if necessary in the event an acceptable agreement cannot be obtained."

The minutes of the Corporation's October 7, 1992 Board meeting indicate that the Minister agreed to support the resolution passed at the Board's October 5, 1992 meeting. A redrafted interim agreement was forwarded to BOVAR. However, the changes called for in the redrafted agreement addressed few of the major concerns outlined by the President in his June 1992 letter to the Minister. And when the amended joint venture agreement was eventually signed in April 1993, some of the changes called for in the October 6 draft interim agreement had also been dropped.

The amended joint venture agreement

The amended joint venture agreement changed the terms of the original agreement in a number of ways, the most significant of which were as follows:

- The Corporation, or BOVAR with the Corporation's permission, could at any time lock in the prevailing interest rate in the guaranteed return on investment formula. This reduced the Corporation's vulnerability to interest rate fluctuations.

- Under certain circumstances where the Joint Venture earns profits in excess of BOVAR's guaranteed return on investment, the Corporation will be reimbursed certain of the past guaranteed return on investment payments to BOVAR.

- The Corporation would be responsible for all site remediation costs when the Swan Hills facility closes. Previously, it appears that these costs were to be shared by the joint venturers in the ratio of their participation.

- Default by BOVAR on its bank loan would result in the Corporation having to purchase BOVAR's interest in the Joint Venture at the lower of the bank loan outstanding and value of BOVAR's investment in unamortized capital assets and working capital. Under the original agreement, a buy-out could have cost the net present value of ten years projected income, a much larger figure. To obtain the agreement of BOVAR's banker to this change, a creditor agreement was executed under which the Corporation agreed to guarantee BOVAR's bank borrowing up to $100 million.

Findings

<u>The original joint venture agreement</u>

In my view, the decision to enter into the 1987 joint venture agreement was a strategic mistake which contributed to subsequent excess costs. This view is based on the following evidence:

- BVRS' Joint Venture investment is essentially free of business or financial risks. All risks associated with operating losses or excess capital investment are borne by the Province. BVRS' capital cost recovery and return on investment are guaranteed, and are based solely on the amount of money that BVRS invests in the Joint Venture. This arrangement provides no incentive for BVRS/Chem-Security to operate the Swan Hills facility economically or efficiently. In fact, the more money that BVRS

invests in plant expansions, the more profit it is guaranteed to make.

The Province even assumed BVRS' banker's risks. If BVRS defaulted on its borrowing obligations, the banker could require the Corporation to purchase BVRS' investment in the Joint Venture. Furthermore, until it was changed in the 1993 amended joint venture agreement, the banker could require the Corporation to purchase BVRS' investment at the net present value of ten years forecast income plus amortization and non-cash expenses, which could be considerably in excess of the amount actually invested by BVRS or borrowed from its banker.

- The return on investment that BVRS is entitled to receive under the joint venture agreement is generous, particularly when compared to the "return on equity" allowed to investor-owned utility companies whose profits are regulated by the Alberta Energy and Utilities Board. Regulated utility companies are normally allowed a return on debt capital sufficient to recover their borrowing costs, and a return on equity capital at a higher rate which compensates for business risks. Under the joint venture agreement, BVRS receives the higher rate on both debt and equity capital, while assuming very little, if any, business risk.

- Several of the termination or buy-out provisions of the joint venture agreement disadvantage the Province. Every five years, BVRS can require the Corporation to purchase BVRS' investment in the Joint Venture at a price which approximates amortized cost. If, at any time, the Corporation materially breaches the terms and conditions of the joint venture agreement, BVRS can require the Corporation to purchase BVRS' investment at the **greater** of amortized cost and the net present value of ten years forecast income plus amortization and non-cash expenses.

  The only two ways that the Corporation can initiate a buy-out of BVRS are (i) if BVRS materially breaches the joint venture agreement, or (ii) if at a five year review date, the Corporation can demonstrate that its future payments to cover operating deficits and BVRS' return on investment will be unreasonably high and unlikely to decline over the next five years. However, "unreasonably high" is not defined in the agreement. In either of these two events, the buy-out price is amortized cost.

BVRS cannot be faulted for negotiating a favourable agreement. The Province, however, was negotiating from a position of strength and should have been able to ensure that the agreement was fair and reasonable to both parties. Yet throughout the four and a half years

of negotiating, the Province's negotiators continually surrendered their bargaining positions. The following are but two illustrations of this:

- Two conditions contained in the "Request for Proposal" were that the proponent (Chem-Security) would be responsible for financing the construction of the facility and for determining that there would be sufficient waste available for treatment. Yet both of these conditions were later abandoned. The joint venture agreement requires the Province to fund 40% of capital costs and to assume all risk of losses due to there being insufficient waste, or for any other reason.

- Even when interim agreements were signed during the negotiations, the government negotiators often released BVRS/Chem-Security from their obligations. The December 1984 Letter of Undertaking is an example of this. The Letter called for BVRS to receive a (presumably pre-tax) return on investment of between prime plus 4% and prime plus 9.5%, accept downside risk on waste volumes, accept a ceiling on net income, and provide 80% to 100% of its investment from equity capital. Yet the joint venture agreement ultimately provided an after tax return on investment of prime plus 3%, with BVRS accepting no downside risk on volumes, no ceiling on net income, and all BVRS' investment being provided by debt, with the Province in effect guaranteeing that debt.

It is clear from the Corporation's minutes that during the final few months of 1985, the majority of Board members were opposed to an agreement on the terms being sought by BVRS. This was confirmed in December 1985 when the Board voted, in effect, to refuse to negotiate further and refer the matter to the government for a decision. The following excerpts from the Corporation's minutes also show that the Board had misgivings about BVRS as an appropriate partner:

- "It is important for the members to realize that because of this [Bow Valley Industries'] restructuring, they are dealing with a firm that has some major difficulties in raising equity or long term debt; hence their need for high cost short term financing."

- "...members varied in their bottom line as to the level of cost the public should bear given the financial risks BVRS/CSL were willing and able to assume..."

- "...if we were able to tell BVRS/CSL that we were able to accept their proposed alternative, then they would indicate that it was unacceptable and would keep chipping away for more..."

- "...given what we know today, [November 26, 1985] and Woods Gordon's assessment of the investment from the Crown's point of view, it is a social program not an investment opportunity for the private sector. ...BVRS/CSL are not willing or not able to take any normal investment risks."

Yet despite these misgivings, agreement on terms and conditions for a Joint Venture was announced in March 1986.

So how much excess cost was incurred?

The extent to which the original joint venture agreement contributed to excess cost to the Province is difficult to quantify. If the Province had built and owned the Swan Hills facility and paid a private sector organization to operate it, I estimate that the $62 million paid to BVRS as a guaranteed return on investment could have been reduced by an amount ranging from $12 million to $17 million. Furthermore, while I have no evidence that Chem-Security operated the facility in an uneconomic fashion, I am confident that operating costs would have been less if BVRS/Chem-Security had been sharing the facility's business risks.

<u>The amended joint venture agreement</u>

Unless BOVAR materially breached the terms and conditions of the original joint venture agreement, the Corporation could not force a buy-out of BOVAR's investment unless it could demonstrate that future payments to cover operating deficits and guaranteed return on investment would be unreasonably high and unlikely to decline over the next five years. While "unreasonably high" is not defined in the joint venture agreement, the Corporation had received legal advice in 1992 that it had grounds for invoking a buy-out.

It is acknowledged that waste was being stored at Swan Hills and around the Province because the facility was unable to treat all available waste. This meant that without an expanded facility, the Corporation would fail to achieve its legislative objective, which would be a matter of public concern.

Nevertheless, given that:

- the Corporation was seriously concerned that the original joint venture agreement was providing BOVAR with a generous risk-free return on capital invested, and no incentive to operate the Swan Hills facility economically, and

- the waste forecasts upon which the major expansion had been based were provided by BOVAR/Chem-Security who, if the joint

venture agreement remained substantially unchanged, could only gain and could not lose financially, even if the forecasts were materially incorrect, and

- BOVAR's own financial position was probably such that it needed a substantially unchanged joint venture agreement to raise its share of the funding for the major expansion,

the possibility of invoking a buy-out of BOVAR's investment in the Joint Venture for less than $40 million provided powerful negotiating leverage. I believe that the negotiating strategy outlined by the Corporation's President in June 1992 was sound, and that not using all available leverage to improve the Province's position was a strategic mistake.

Conclusions

Had the Alberta Government's current three-year business planning and committee review process been in place from July 1982 onwards, reporting would have focused on what was to be achieved, and at what cost. This process would have focused debate on any proposed changes to original objectives and costs. It is my belief that focusing attention on the financial effects of the changing terms and conditions being negotiated would have produced government support for the Corporation's Board position that the original agreement unduly disadvantaged the Province.

To embark on a major and costly expansion without a joint venture agreement which shared the risks and costs more equitably, was to further increase the Province's risk of incurring excessive costs.

Recommendation

Recommendation No. 1

It is recommended that the effect on three-year business plans of significant changes to major programs or capital expenditures be quantified before the changes are implemented. Changes should be measured in terms of their effect on the originally planned outputs and costs.

THE MAJOR EXPANSION OF THE SWAN HILLS FACILITY

PAGE

Key events

June 1991	Chem-Security submitted an environmental impact assessment to the Department of the Environment for a proposed expansion to the Swan Hills facility.
June 1991	Order-in-Council 377/91 designated the Swan Hills facility expansion as a project to be reviewed by the NRCB.
July 1991	Chem-Security filed an application with the NRCB for approval to expand the Swan Hills facility.
May 1992	The Natural Resources Conservation Board (NRCB) approved, with Cabinet authorization, an expansion of the facility's rated incineration capacity.
October 1992	Construction began on the incineration expansion at the Swan Hills facility.
December 1992	The Department of Environmental Protection announced that oilfield waste was to be excluded from the definition of hazardous waste in the Environmental Protection and Enhancement Act Waste Control Regulation.
October 1993	The major expansion of the facility was completed and test burns commenced thereafter.

Why the expansion was needed

In March 1989, Chem-Security reported to the Joint Venture Operating Committee that increased incineration capacity was needed to meet current and projected demand. To address this problem, the Corporation approved the immediate acquisition of a small rotary kiln costing $9.4 million. To meet future demand and to deal with backlogs, however, Chem-Security proposed installing an additional much larger rotary kiln.

At a December 1989 meeting of the Corporation's Board attended by the Minister of the Environment, the proposed expansion was discussed at length. A briefing document was distributed which had been prepared to assist the Minister when the Corporation's 1990-91

budget was reviewed by the Treasury Board. Some of the information in the briefing document was as follows:

- The cost of the expansion was estimated at $50 million.
- The current backlog of wastes requiring treatment was estimated at 45,000 tonnes, and Alberta's ongoing generation of waste was estimated at 15,000 tonnes per year.
- The Swan Hills facility could incinerate the ongoing generation of waste but not the backlog in storage. This meant that the Corporation was not discharging its legislative mandate.
- The backlog could be eliminated through additional incineration capacity. By adding capacity of 25,000 tonnes per year, the backlog could be eliminated by 1997, or by adding capacity of 40,000 tonnes per year, it could be eliminated by 1995. Once the backlog was eliminated, however, waste stream estimates indicated that the additional treatment capacity would be underutilized.
- The best scenario would be achieved by adding capacity of 40,000 tonnes per year, thereby eliminating the backlog quickly, though it was acknowledged that underutilized capacity thereafter would result in the need for continued financial support by the Corporation.

The Corporation was confident that the additional capacity could be justified by new waste streams and the tightening of regulations. The Board minutes show that the Minister advised the Corporation's Chairman that environmental emphasis over the coming months would be on regulation and enforcement, and that this would assist the Corporation's efforts.

In October 1990 in a speech to the Calgary Chamber of Commerce, the Minister of the Environment spoke about the Swan Hills facility's inability to incinerate all the Province's waste. He stated that "Our new environmental legislation will mean...we will have to have increased means of disposing of the wastes." He also stated that "I have directed my Department to review existing regulations and make a recommendation to determine whether more types of special wastes should be directed towards Swan Hills."

Application for approval to expand the facility

In July 1991, Chem-Security applied to the NRCB for approval to expand the Swan Hills facility. The proposal was for a rotary kiln costing $60 million with a rated capacity of 40,000 tonnes per year to augment the existing twin rocking and rotary kilns.

The NRCB hearings began in November 1991. Chem-Security provided two projections of waste volumes that would be available to an expanded treatment facility. The first projection was based on waste forecasts obtained by Chem-Security from waste generators who used the Swan Hills facility. Based on these forecasts, Chem-Security estimated 1991 waste treatment demand at 25,000 tonnes, increasing by 5% per year thereafter. It was further estimated that about 90,000 tonnes of waste were in storage in Alberta, of which about 40,000 tonnes were expected to be treated at Swan Hills. Chem-Security, however, would not provide the NRCB with the detailed customer information on which its forecasts were based because it was represented as being confidential in nature.

Chem-Security's second projection was based on a report prepared by consultants David Bromley Engineering (1983) Limited (Bromley). This report, which was based on Bromley's own data, forecast that waste treatment demand could be 47,500 tonnes per year from ongoing generation and 32,500 tonnes per year from inventoried waste. The Bromley report also forecast that by the year 2002, demand could be 37,500 tonnes of waste per year from ongoing generation and 24,750 tonnes per year from inventoried waste.

The NRCB report

The NRCB report acknowledged concerns expressed by intervenors about the methodology used by Chem-Security to develop waste volume forecasts. It concluded, however, that obtaining information directly from waste generators was probably the best practical way of developing forecasts. This, coupled with the knowledge that not all Chem-Security customers were interviewed, plus the Bromley estimate, satisfied the NRCB that the minimum volume of waste that would be available for treatment at Swan Hills from ongoing generation was likely to be at least 25,000 tonnes per year. The NRCB also accepted that an average of 20,000 tonnes of waste per year would be available from inventories for at least ten years following any expansion of the facility.

During the NRCB hearings, Chem-Security indicated that "Industries have an expectation that the regulations will get tougher, and this would have an impact on them." The NRCB acknowledged that major regulatory changes were taking place, and believed that these changes were unlikely to relax hazardous waste treatment requirements. In fact, the NRCB expected ongoing pressure for more stringent waste-related regulations.

Using the forecast treatment prices, a $60 million capital cost, estimated operating and maintenance costs, and the waste volumes forecast to be available to the facility, Chem-Security estimated that revenue during the initial ten year operating period would meet all operating and other expenses, service the debt, and recover the invested capital.

The NRCB's economic analysis, using data provided at the hearing, suggested that over the range of waste volumes expected to be available to the facility, and over most of the range of treatment prices provided by Chem-Security, the project would be economically viable. Indeed, based on the NRCB's economic calculations, it agreed with Chem-Security's suggestion that expanding the facility to treat all available volumes of waste would go a long way towards ensuring that public financial support would not be needed.

On April 30, 1992, the NRCB approved Chem-Security's application to expand the facility's incineration capacity, subject to obtaining the necessary authorization from the Lieutenant Governor in Council. Installation of a 40,000 tonne per year rotary kiln began in October 1992 and the expansion was completed in October 1993.

The estimated capital cost of the expansion used by Chem-Security and the NRCB in their economic viability analyses was $60 million. The eventual cost of the expansion was $104 million.

It appears that $60 million was Chem-Security's preliminary estimate of the capital cost of the expansion project. However, when the contract was tendered after the NRCB had approved the expansion, the kiln chosen increased the capital cost to $68 million. After that, an early completion bonus, commissioning costs, a production incentive payment and other incidental costs increased the total capital cost to $79 million. A further $16 million was spent expanding the operations and maintenance facilities, waste storage facilities, the laboratory, and the stabilization and solidification plant, all of which were needed to accommodate the operation and outputs of the larger kiln. By the time the costs of preliminary engineering, the NRCB expansion hearings, the environmental impact assessment, public meetings, and other ancillary costs were included, total capital costs associated with the expansion were $104 million.

Regulatory changes - oilfield waste exemption

At the time the major Swan Hills expansion was being planned, the Department of Environmental Protection was revising Alberta's environmental legislation. A new Environmental Protection and Enhancement Act was being developed, together with a Waste Control Regulation to replace the old Hazardous Waste Regulation.

The 1985 and 1987 Hazardous Waste Regulation specifically exempted upstream oilfield waste from the definition of hazardous waste. The proposed new Waste Control Regulation drafted in May 1991, however, contained narrower exemptions for oilfield waste. In effect, the draft regulation required upstream oilfield waste to be treated in the same manner as other industrial wastes.

In September 1991, the Department invited public comment on the draft regulation. Public information sessions were held in October and November 1991. Workshops were held in 1992 and task forces and working groups were formed to discuss the proposed new regulation. The Corporation and Chem-Security both participated in these workshops.

At about this time, the Canadian Petroleum Association and the Independent Petroleum Association of Canada submitted comment on the proposed Waste Control Regulation. Both expressed the view that, because the Energy Resources Conservation Board (ERCB) was the oil and gas industry's primary regulating body and familiar with the nature of oilfield waste, it should also be responsible for that industry's environmental reviews. Both associations expressed concern that the proposed regulations would be costly for the upstream petroleum industry, and would cause the industry further hardship in already difficult economic times.

Construction of the major expansion at Swan Hills began in October 1992. In December 1992, the Department announced that oilfield waste would be excluded from the definition of hazardous waste in the Waste Control Regulation. Instead, the ERCB would be responsible for regulating oilfield waste. The Department stated, however, that oilfield waste exempted under the new Waste Control Regulation should receive the same level of care and management as non-oilfield hazardous waste subject to the Waste Control Regulation.

In January 1993, the Corporation wrote both the Minister of Environmental Protection and the Premier stating that the Corporation "strongly opposes the exemption of oilfield hazardous waste from...the control of Alberta Environment. The ERCB has suggested that they will require equivalency with Alberta

Environment standards in their regulations, but it is the understanding of the [Corporation] that under pressure from industry they are already developing guidelines which allow continued and enhanced use of deep well injection, landfills and landfarms for the disposal of oil field hazardous waste. ...The [Swan Hills] treatment centre has been heavily subsidized due to its relatively small production capacity. The current expansion should turn this around but if hazardous wastes are allowed to go to less environmentally acceptable options such as landfill, the possibility of the government being able to recoup its investment becomes less likely."

In April 1993, Chem-Security submitted to the Department of Environmental Protection its concerns about the latest draft of the Waste Control Regulation. Among other things, it expressed concern that hazardous oil and gas waste was excluded from the Regulation's application and that oilfield waste would be allowed to be deepwelled and landfilled.

In a July 1993 memorandum to the Minister of Environmental Protection, the Corporation's Chairman predicted that without volumes of waste that would allow the new Swan Hills kiln to operate at maximum capacity, the Corporation's subsidy to the Joint Venture would increase substantially. The kiln had been installed on the assumption that legislation would be strengthened to restrict landfilling and deepwelling, and that hazardous wastes from the oil and gas industry would be treated in the same manner as other industrial wastes. The Chairman indicated that the recently approved Waste Control Regulation did not meet either of these expectations. He also stated that without regulatory support, only limited volumes of waste would be sent to Swan Hills for "high grade" treatment.

Findings

In my view, a costly strategic mistake was made in proceeding with the major expansion without first ensuring:

- that the capital costs to be incurred, which would be the basis of future return on investment payments to BOVAR, would be consistent with the future economic operation of the Swan Hills facility, and

- that the regulatory requirements necessary to obtain the facility's forecasted waste streams were in place.

Capital costs

Chem-Security estimated the capital cost of the proposed expansion at $60 million. In September 1991, in response to a request for further information, Chem-Security informed the NRCB that "The [$60 million] capital cost of the expansion project includes not only the cost of an incinerator but also the costs associated with expanding the supporting infrastructure such as the utility services, personnel amenities, buildings, site servicing and project engineering."

The eventual capital cost of the expansion, including all ancillary infrastructure and amenities was $104 million. A capital cost discrepancy of this magnitude would invalidate the economic assessment of the expansion provided by Chem-Security, and endorsed by the NRCB.

Waste stream forecasts

A number of factors seem to have contributed to the facility's waste streams being considerably less than were forecast. Efforts by industry to reduce costs have resulted in improved waste-minimization techniques and more on-site treatment by waste generators. As well, the increasing practice of selling hazardous waste as cement kiln fuel not only reduced the waste that required treatment, but also depressed prices generally in the waste treatment industry.

Nevertheless, a major reason why the facility's waste stream volumes were over-forecast appears to have been substantially less demand than was forecast for the treatment of oilfield waste.

So why did the forecast volumes of oilfield waste that would require treatment at Swan Hills fail to materialize?

I have found this question the most difficult to answer.

The waste volume forecasts were provided by Chem-Security, were supported by Bromley, and were accepted by the NRCB. There are differing views, however, on the regulatory assumptions underlying the forecasts.

It is important to recognize that waste treatment streams are highly sensitive to the legislative definitions of hazardous waste and regulated treatment requirements. Alberta's 1987 Hazardous Waste Regulation defined hazardous waste and related treatment requirements, but specifically excluded upstream oilfield waste from

the Regulation's application. Instead, oilfield waste and treatment requirements were regulated by the ERCB.

During 1990 and 1991, there was a growing expectation among most waste generators in all industries that the definition and enforcement of hazardous waste regulations would become more stringent. In May 1991, the Department of the Environment drafted a Waste Control Regulation that called for all hazardous waste, including upstream oilfield waste, to be defined and treated in the same manner. The Canadian Petroleum Association and the Independent Petroleum Association of Canada both concluded that the regulation would be costly for the upstream oilfield industry. This suggests that the previous treatment of oilfield hazardous waste was less stringent than waste governed by the Hazardous Waste Regulation.

When the NRCB expansion hearings were held, however, the 1987 Hazardous Waste Regulation was still in effect and the proposed new Waste Control Regulation was in draft form.

In my view, the evidence about waste stream forecasts submitted to the NRCB was contradictory. The following is a sample of the evidence submitted which suggests that the forecasts **were not** based on the expectation of new regulations:

- Chem-Security stated that the forecast "represents the volumes of waste that will likely enter the system given existing sales agreements, trends and regulatory factors."

- In the same document, Chem-Security also stated that "...this evaluation of Alberta's organic waste treatment requirements is considered conservative for the following reasons: ...it has not taken into account the likely emergence of new waste sources as a result of new regulations."

- Although Chem-Security's customer surveys were conducted before the proposed new regulation was drafted, when responding to questions as to whether the impact of new regulations was discussed when gathering information from Swan Hills' customers, the Chem-Security representative stated "Yes they were. And I might point out that in our assessment they... had been very heavily discounted. ...on the conservative basis that we used, we did not go out there and say, hey, the regulations are coming in, that's going to increase the waste."

The following sample of evidence, however, suggests that the forecasts **were** based on the expectation of new regulations:

- Chem-Security provided the NRCB with an analysis of its forecasts which showed that 13,400 tonnes per year of forecast waste would come from oil and gas sources. I understand that the Swan Hills facility had never before received as much as one fifth of that volume from oil and gas sources.

- In response to the question “Is it your assumption that by broadening the categories of hazardous waste, which I’m assuming the proposed regulations to do, that there will be more wastes classified as hazardous?” the Chem-Security representative answered “Yes.”

- In response to the question “If the oil and gas industry receives further exemptions from the Hazardous Waste Regulation, what are the consequences for the projections..?”, David Bromley responded “There is no intent by Alberta Environment to provide an exemption to wastes generated by the oil and gas industry... On the contrary, as in the draft Hazardous Waste Regulation, the clause which was causing the confusion...has been removed.”

I have examined the NRCB decision report on the incinerator expansion, and have discussed it with NRCB officials. I am satisfied that the NRCB based its approval of the expansion project on the assumption that the waste stream forecasts were not dependant on a change in the regulations.

By contrast, the actions of the Corporation following the announcement that the Waste Control Regulation would not apply to oil and gas industry waste (as described earlier), suggest strongly that the Board believed that the forecasts were heavily dependent on the new regulation applying to oilfield waste. Senior officials of the Corporation have also informed me that the forecasts were based on the assumption that there would be no exempt wastes, and that all waste generators would comply with similar regulations.

Most representations I have received from Chem-Security officials also indicate that the waste stream forecasts included oilfield waste resulting from anticipated regulatory changes. Chem-Security’s General Manager indicated that oil and gas companies had begun sending additional waste to Swan Hills in anticipation of regulatory changes. He believes that the oil and gas companies were assuming that this trend would increase when they provided his company with estimates of future waste streams. However, when the government announced that oilfield waste would be exempted from the application of the Waste Control Regulation, oilfield waste arriving

at Swan Hills reverted to the original volumes. Chem-Security also informed me that "The exemption of oilfield waste from the EPEA regulations has the effect of removing approximately 50% of the forecasted volumes from the projected ongoing waste generation and approximately 30% of the inventoried waste."

Both the Corporation and Chem-Security have also indicated that the expectation of increased oilfield waste was based on assurances from the Department of Environmental Protection. This appears to be corroborated by a report published by the Department in 1993 in response to public comments on the proposed new regulation. The report states that "The Department...agreed that oilfield wastes should receive the same care and management as similar waste produced by others. In the interest of maintaining a one-window with government, the ERCB will be given the responsibility for regulating oilfield waste."

The new Waste Control Regulation came into force in September 1993, and excluded oilfield waste from its application. The Department stated that it expected the ERCB to apply the same management and enforcement standards to oilfield waste that the Waste Control Regulation does to other industrial waste.

It is my understanding that the ERCB (now the Alberta Energy and Utilities Board) uses policy guidelines to regulate the disposal of oilfield waste. However, I have been unable to determine the extent to which these policy guidelines result in oilfield waste receiving "the same care and management as similar waste produced by others" that is subject to the Waste Control Regulation, though it appears that much of the oilfield waste that is being disposed of off-site is being treated at facilities other than Swan Hills.

Conclusions

In my view, the December 1992 decision to exempt oilfield waste from the application of the Waste Control Regulation significantly reduced the waste that would otherwise have been available to the Swan Hills facility. Based on discussions with senior officials of the Corporation and Chem-Security, I am satisfied that had the government decided to exempt oilfield waste before October 1992, construction of the major expansion at Swan Hills would have been delayed pending revised estimates of future waste streams.

Other factors that would have influenced revised waste stream forecasts were the rapidly increasing efforts by industry to improve waste-minimization techniques, more on-site treatment by waste generators, and the growing practice of selling hazardous waste as a cement kiln fuel. In combination, these other factors would also

have significantly reduced the original waste stream forecasts presented to the NRCB.

Whether allowing the importation of hazardous waste from other provinces will utilize the Swan Hills facility's idle capacity, remains to be seen. What is certain, however, is that the expansion of the Swan Hills facility has significantly increased the cost to the Province of divesting itself of its investment in the Joint Venture.

Recommendation

Recommendation No. 2

It is recommended that when proposed major programs or capital expenditures are dependent on future events, the minister responsible disclose in the entity's three-year business plan an evaluation of the downside risk to the plans proposed.

Principal Officials

Environment Ministers:

Hon. Jack Cookson	Mar 1979	to	Nov 1982
Hon. Fred Bradley	Nov 1982	to	May 1986
Hon. Ken Kowalski	May 1986	to	Sep 1988
Hon. Ian Reid	Sep 1988	to	Apr 1989
* Hon. Ralph Klein	Apr 1989	to	Oct 1992
Hon. Dick Fowler	Nov 1992		
Hon. Ralph Klein	Dec 1992		
Hon. Brian Evans	Dec 1992	to	Oct 1994
Hon. Ty Lund	Oct 1994	to	present

Chairmen of Alberta Special Waste Management Corporation:

John P.C. Elson	Jun 1984	to	Dec 1985
R. Lorne Mick	Jan 1986	to	Mar 1987
Robert C. Clark	Apr 1987	to	May 1992
A.J. Maiani	Jun 1992	to	Dec 1994
Jon Havelock, MLA	Jan 1995	to	present

Presidents of Alberta Special Waste Management Corporation:

R. Lorne Mick	Apr 1987	to	Feb 1990
Ken J. Simpson	Mar 1990	to	Dec 1994
Bob King	Jan 1995	to	present

* Hon. Ralph Klein announced his intention to run for leadership of the Progressive Conservative Party on September 17, 1992. On October 14, 1992, Cabinet decided that the ministerial duties of leadership candidates should be discharged by acting ministers with effect from October 30, 1992.

EXECUTIVE COUNCIL

Accountability

Introduction

The government continues to make significant improvements in public accountability. Major advances are the Government Accountability Act and performance measures in *Measuring Up* (June 1995) and in ministry annual reports. These are unique accomplishments in Canada.

With these major changes, the government continues to move decision making away from the center to accountable and empowered organizations. At the same time, the government is encouraging managers to assess the benefits and cost effectiveness of the programs and services funded by government.

Traditionally, governments have controlled spending via a budget that estimates the cash that is to be spent on such things as grants, salaries and supplies. Budgets have not attempted to quantify the cost and the benefits of the various services that are to be funded.

The government's three-year business plans that now supplement the annual budget process increasingly focus on estimating the cost and effect of proposed outputs and services. Many three-year plans now contain performance measures and targets. I view these developments as critical to the long-term efficiency of government.

Clearly, an Alberta Accountability Framework is taking shape. However, the difficult and demanding work of using the framework to measure and report on government services continues. This work will test the resolve of those in government who believe that performance improves with effective public accountability. To be successful, these visionaries will continue to need the unwavering support of the Members of the Legislative Assembly.

I expect the public to see further improvement in accountability as a result of:

- Integrated plans and budgets - When the government integrates three-year business plans and budgets, Albertans will see clearly the planned costs and expected results of the government's programs and services together with information on how performance will be measured.
- Integrated performance reports - When the government integrates its two main performance reports—the consolidated financial statements of the Province and *Measuring Up* (June 1995)—

Albertans will be able to compare actual results with goals in both monetary and non-monetary terms.

- Ministry reports - When the government consolidates the financial reporting of all entities controlled by a minister, then one set of financial statements will deal with one set of responsibilities. Planning, budgeting and reporting will be aligned with responsibility.

Our role

A major goal of the Office of the Auditor General of Alberta is to actively promote clarity in reporting within an accountability framework that links plans and costs to results and effects. To this end, we have published a document entitled *Government Accountability*. Accountability is all about measuring and reporting on results achieved. Such performance measurement encourages continuous improvements in economy and effectiveness. In *Government Accountability*, we describe the guidelines we will use to assess the effectiveness of an accountability framework. The document's primary purpose is to help our staff in auditing accountability reports. We also use it to discuss accountability and performance reporting with our clients and other interested parties.

In addition, a senior member of the Office served on a Treasury Board task force that studied the performance measures proposed for *Measuring Up* (June 1995). Other staff became members of several teams established to implement the government's performance measurement initiatives. We have also spoken to our clients' governing bodies and their executives about the importance of measuring and reporting the cost and effect of outputs.

Accountability guidelines

As noted above, we have proposed a set of guidelines that our clients and staff can use to assess the effectiveness of an accountability framework. Publishing the guidelines has stimulated debate on the important subject of accountability and the need to report on cost-effectiveness. The guidelines are:

1 Accountability is necessary when responsibility is assigned and authority is delegated.

2 The basic characteristics of accountability information are understandability, relevance, reliability, and comparability. Also, the cost of providing accountability information should not exceed the expected benefit.

3 All forms of accountability reporting should provide information on outputs.

4 Expected results need to be clearly expressed and must be measurable.

5 Accountability reports should link information on the costs of outputs with information on their effects.

6 A ministry accountability report should include all the Provincial organizations accountable to the minister.

7 Each organization and fund should prepare plans (including budgets) and performance reports.

8 Plans should be prepared by those who have been assigned responsibility. The plans should state results to be achieved, actions to be taken and by whom, estimated costs and performance targets. Those who assign responsibility should agree to the plans.

9 Performance reports (such as financial statements and annual reports) should compare actual to planned results.

#10 Key accountability reports, including plans, budgets, financial statements and annual reports, should be made public.

#11 Published performance information should be audited.

#12 Accountability processes within a Provincial organization should be consistent with, and support, accountability to the minister and the Legislative Assembly.

#13 The main elements of an effective accountability framework should be legislated.

Recommendations

Last year, we presented five recommendations designed to assist the government improve accountability. The recommendations were accepted and work started on implementing them. This year, I have three additional recommendations. I have repeated two of last year's recommendations in order to present a comprehensive view of what I believe needs to be achieved.

Government Accountability Act

In the 1993-94 annual report (page 13), the Auditor General recommended that the Treasury Department develop an Alberta Accountability Framework and communicate it to Provincial organizations.

In May 1995, the members of the Legislative Assembly passed Bill 40 and the Government Accountability Act received Royal

Assent. Alberta is now in the position to reap the benefits of a legislated accountability framework.

The Treasury Department has established small teams of specialists to help in implementing the framework. My staff has worked closely with these teams in the development of performance measures, departmental financial statements and other initiatives. In the future, I would like my Office to work with the Treasury Department to jointly issue a handbook of guidance on developing performance measures for government organizations.

Departmental financial statements

In the 1993-94 annual report (page 12), the Auditor General drew attention to the need for departmental financial statements. During the year, senior staff of the Office worked with a task force, led by the Treasury Department, that proposed a set of departmental financial statements. The proposal was accepted and a new task force, with representation from my Office, has started the work on implementing it. I understand that the goal is to issue departmental financial statements commencing with the 1996-97 fiscal year.

Consolidated ministry reports

The new Government Accountability Act, assented to in May 1995, is an exciting and important step in addressing the recommendation to produce consolidated ministry reports which was made in the 1993-94 annual report (page 12). I look forward to assisting those in government who will be asked to implement the required reporting when the Act is proclaimed.

Estimates

Recommendation No. 3

It is recommended that the government review the form of the Estimates to assess whether information on the cost of outputs and performance targets should be included.

The government stated in *Measuring Up* (June 1995), its first annual report, that there will be "...growing emphasis on achieving results, on tying budget decisions to programs that work well....". Integrating expected results and performance measures into the Estimates by using outputs as the base will greatly help in the change.

The requirement for the Estimates is established under current legislation. Their form has a long-standing parliamentary tradition which has stood the test of time. The Estimates are the means by which the Assembly exercises its fundamental right to approve the expenditure of the government. Therefore, any changes to the form of the Estimates, must be carried out carefully. I believe, however, that the current form of the Estimates should be reviewed to identify

whether expected costs and results can be integrated for approval purposes.

The Estimates are the primary budget document used by the Legislative Assembly. In their current form, the Estimates focus primarily on inputs. Through the annual Appropriation Acts, the Assembly is asked to approve the acquisition of these inputs. Providing information in the Estimates on the cost and effect of outputs would help Members of the Legislative Assembly in their review of proposed expenditures.

On page 165 of this report, I comment on the progress made in preparing the annual consolidated budget on the same basis as the consolidated financial statements. Such reporting will facilitate comparison of planned and actual financial results.

Outputs

Recommendation No. 4

It is recommended that plans, annual reports and financial statements provide information on outputs. It is further recommended that plans and reports provided by organizations to their ministers identify the outputs to be produced and the expected full cost of the outputs. These plans should show the contribution the organization will make to ministry and government goals.

In the 1993-94 annual report (page 11), the Auditor General recommended that accountability documents provided to the Legislative Assembly, including three-year business plans, budgets, annual reports and financial statements, be based on outputs. The recommendation was made to focus attention on the fact that it is through outputs that costs and effects are linked. The report acknowledged the government's further progress on its May 1993 initiative to require Provincial agencies to submit three-year plans. Work has begun in several organizations to shift the planning and reporting focus to outputs.

Plans and annual reports contain performance information, whereas budgets and financial statements contain cost information. It is not sufficient to speak exclusively of costs or exclusively of results. Information on costs and results must be brought together. Goods and services (called outputs) are the common link between costs and results. The costs of outputs can be determined. Also, the immediate impacts of outputs are determinable. Recognition that it is through outputs that costs and effects are linked is growing. As much remains to be done, I have repeated the recommendation

The need to focus plans and reports on outputs is particularly true of the plans provided to ministers. The government sets out its goals annually in the government's business plan—*A Better Way*—which describes the broad outcomes it plans to achieve. To accomplish these outcomes, organizations are funded to deliver goods and services (outputs).

This focus on outputs is required to reflect the intention of management to deliver outputs required by the government. To be more useful, the plan should state the contribution the organization's outputs will make to the minister's and the government's goals and how the contribution will be measured. A minister can then assess the appropriateness of the organization's plan in relation to these overall goals.

Full costing

Recommendation No. 5

It is recommended that the Province develop systems to allocate all costs that are material, including a cost of capital employed, to organizations responsible for delivering outputs.

I believe that organizations need to understand and report the full cost of their outputs. Progress is being made in the allocation of costs, but more work needs to be done.

Sometimes organizations do not pay for all the costs of their operations since central agencies pay the costs for them. However, organizations need to know these costs if costs and benefits are to be assessed. Knowing the full cost of outputs is essential to decision making, especially when ministers select between alternatives.

On page 171 of this report, I have made a specific recommendation to the Treasury Department on revolving funds.

Costs include the cost of capital employed by an organization. Private sector companies raise capital to operate. They do this through selling shares or borrowing money. In both cases, the provider of capital—the investor—expects a return on the capital provided.

In government, money borrowed centrally is used to provide the capital needed to acquire the assets for service delivery. No charge is made to organizations for the cost of providing them with capital to acquire assets. However, by charging for the cost of capital, the full cost of outputs could be determined. Management would have an incentive to ensure that assets were productively used.

Supplementary performance information

Recommendation No. 6

It is recommended that financial reports include supplementary performance information.

I am very encouraged with the progress on this recommendation first made in the 1993-94 annual report (page 11). The publishing of *Measuring Up* (June 1995) and performance measures in ministry annual reports are important first steps. The measures in these reports will be refined in upcoming years through experimentation and study.

Traditional financial statements and annual reports include information on the acquisition and use of resources. However, to evaluate cost-effectiveness, readers also need information on results achieved in terms of the goals set. Performance measures which focus on results provide the necessary information. Therefore, performance measures should be included in the financial statements or annual report.

I would prefer performance measures to be included in financial statements so that users can find audited performance information in one place. Currently most organizations which provide performance measures do so as part of their Annual Report. I believe that when organizations are satisfied with their measures, they would then be moved individually from annual reports into financial statements. In this way, the auditor's report would cover these measures and users would have audit assurance that the measures are relevant and reliable. Alternatively, the scope of the auditor's report could be extended to other parts of the annual report, including a schedule of performance measures.

I was able to provide some comfort on the information in *Measuring Up* (June 1995), limited to the specific procedures I could perform. I look forward to expanding the assurance provided by my Office as the systems used to collect and report information on performance in future editions of *Measuring Up*, and my audit procedures, improve and mature.

Rewarding Performance

Since becoming Auditor General, I have had an opportunity to consider the question of rewarding performance in the public service. At the moment, there is no ability to reward improved performance other than through promotion. The only change in management salaries in the past four years has been a reduction of 5%. Managers are handicapped because they cannot provide

financial rewards to those who improve the cost effectiveness of government operations. As was stated in the last Auditor General's Report, unless there are systems to ensure that the best people are rewarded they tend to move on. In my experience, in order to sustain progress, you must be prepared to reward those who contribute to an organization's successes.

If increases in public sector salaries were linked to demonstrated improvements in the cost effectiveness of government operations, with its consequent effect on the deficit, I believe that such increases would be considered reasonable and appropriate. If this approach was adopted, it occurs to me that it would naturally complement the government's agenda on performance measurement. By stating publicly that future salary increases, or a portion thereof, will be linked to published improvements in cost effectiveness, the government would encourage more people to focus on results.

At the present time, all government agencies include details of salaries paid in their financial statements. It seems to me that the key is to link this information on salaries with information on the cost and effect of outputs. If this information were linked, then taxpayers, ministers, MLAs, and public servants would all be able to assess the merits of salary levels and any increases. Rather than Cabinet having to debate the merits of awarding general increases, they would instead assess whether entity management had appropriately linked performance and pay. Management would make pay decisions knowing that they would be held accountable through published financial statements. This approach seems entirely consistent with the government's desire for a more business-like approach to public sector management.

I think the budget process could be used to ensure that salary increases are only budgeted when linked to savings in manpower or other costs resulting from improved cost effectiveness.

In conclusion, I believe that performance could safely be rewarded if management was given the authority to reward, within approved manpower budgets, those employees who contributed to improvements in the cost-effectiveness of operations as reported in financial statements.

Department of Executive Council
year ended March 31, 1995

There were no matters reported to management at the end of this year's annual financial audit.

ENTITIES ADMINISTERED BY MEMBERS OF THE EXECUTIVE COUNCIL

Certain members of the Executive Council have been charged by the Lieutenant Governor in Council with the administration of the following Acts:

- Alberta Educational Communications Corporation Act
- Interprovincial Lottery Act
- Liquor Control Act
- Metis Settlements Accord Implementation Act
- Racing Commission Act
- Wild Rose Foundation Act
- Workers' Compensation Act

My observations on the entities which operate pursuant to these Acts are, therefore, included here under Executive Council.

Lotteries
year ended March 31, 1995

In the 1993-94 annual report (page 15), it was recommended that the government reconsider its rationale for being less accountable for lottery revenues than for other public funds.

In the period since the 1993-94 report, responsibility for the administration of Alberta Lotteries and the Lottery Fund has been consolidated under the Alberta Gaming and Liquor Commission.

I am very pleased to report as part of these new arrangements, effective 1995-96, the costs of operating Alberta Lotteries, including the costs of administering the Lottery Fund, are being funded from an appropriation of the General Revenue Fund under the Minister of Transportation and Utilities. Also, the financial statements of Alberta Lotteries for the year ended March 31, 1995 have been included in Public Accounts 1994-95.

Lottery Fund grant expenditures have been made the subject of a review by the Lottery Review Committee and its report entitled *New Directions for Lotteries and Gaming* is presently being studied by the government.

The Workers' Compensation Board
year ended December 31, 1994

Claim benefit liability

Expenditures in the Board's financial statements do not include an amount for the future administration of existing accident claims. The Board has estimated the future cost to administer existing injured worker claims to be in excess of $100 million.

The claim benefit liability represents the actuarial present value of all future benefit payments the Board expects to make for accident claims which occurred in the current and prior years. The liability includes provision for payments for pension, health care and rehabilitation benefits for injured workers in respect of these claims. However, the liability does not include a provision for future payments for staff and other costs needed to administer the claims. Under accrual accounting, the Board's financial statements should include a liability for these costs.

In recent years, the Auditor General has recommended to the Board that claims administration costs be included in the Board's expenditures in the accident year as part of the accrual for all of the obligations arising from the claims.

I am pleased to report that the Board has recently agreed to this recommendation and intends to change its accounting policy in its 1995 fiscal year. In my opinion, this will result in The Alberta Workers' Compensation Board being at the forefront of Canadian financial disclosure in this regard. Only two other workers' compensation boards in Canada record such expenditures in the year of accident. I congratulate the Board for taking this initiative.

Other Matters Related To Executive Council

Code of conduct and ethics for public service employees

In the 1993-94 annual report (page 20), it was recommended that the Public Service Commissioner update the *Code of Conduct and Ethics for the Public Service of Alberta* to provide additional guidance in potential conflict of interest situations.

I am pleased to note that action has been taken to implement the recommendation and that the Public Service Commissioner's Office has initiated a review of the *Code of Conduct and Ethics for the Public Service of Alberta*. This review has involved discussions with all Provincial departments as well as an examination of codes of conduct and ethics of federal and other provincial jurisdictions. It is my understanding that recommendations from this review will be considered for inclusion in a revised *Code*. I am pleased with the

action taken and my staff will examine progress on this matter in future audits.

Other entities

Financial audits of the following were also completed for the year ended March 31, 1995:

The Alberta Educational Communications Corporation
Alberta Liquor Control Board
Alberta Lotteries
Alberta Racing Commission
Lottery Fund
Metis Settlements Transition Commission
Metis Settlements Transition Fund
Personnel Administration Office Revolving Fund
The Wild Rose Foundation

Department of Advanced Education and Career Development
year ended March 31, 1995

Guidance to reader

The Provincially owned universities, colleges and technical institutes, and The Banff Centre operate under the authority of the Universities Act, the Colleges Act, the Technical Institutes Act, and The Banff Centre Act, respectively. Their financial statements are not included in the Province's consolidated financial statements, but are included in Volume 4 of the Public Accounts.

Annual financial audits, for the year ended June 30, 1995, of the following entities were in progress at the date of this report. Any findings arising from these audits will be included in the next annual report:

Alberta College of Art and Design
Fairview College
Fairview College Foundation
Grande Prairie Regional College
Grande Prairie Regional College Foundation
Grant MacEwan Community College
Grant MacEwan Community College
  - Millwoods Day Care Centre
  - Community Enrichment Project
Keyano College
Lakeland College
Lethbridge Community College
Medicine Hat College
Mount Royal College
Mount Royal College Day-Care Society
Mount Royal College Foundation
Northern Alberta Institute of Technology
Olds College
Olds College Foundation
Red Deer College
Southern Alberta Institute of Technology

The Province, through the Department of Advanced Education and Career Development, intends to provide, in 1995-96, approximately $833 million in funding to post-secondary educational institutions. This funding, in conjunction with revenue raised from tuition fees and other sources, will enable institutions to spend, in aggregate, approximately $1.2 billion in 1995-96.

During this reporting period a number of important initiatives were commenced by the Department and the post-secondary educational institutions. These initiatives include the development of key

performance indicators, defining common information reporting requirements, and public consultations on university research. In June 1995, the Department published a discussion paper entitled "*A Proposed Performance-Based Funding Mechanism for Alberta's Public Post-Secondary Education System*". In addition, new reporting systems are being developed for Departmental and institutional use. I am also pleased that the Department has provided the public post-secondary education sector with certain guidance on financial reporting.

Performance reporting

Members of the Legislative Assembly and the public need performance information to relate costs, educational outputs and effects. For this reason, I believe that the first step is to identify the outputs being funded, and their cost. My Office will continue to assist the Department and the institutions in promoting this objective. To this end, a number of recommendations were made to post-secondary institutions.

The leadership provided by the Southern Alberta Institute of Technology in developing performance information which it will include in its future audited financial statements is to be commended. The performance information will include annual cost per full-time student, cost per graduate, and the success rate of students in finding employment. I believe that such information is useful to members of the Legislative Assembly, students and the public.

Scope of audit work

In addition to the annual financial audit, the following work was completed:

- An examination of the system to promote the accountability of post-secondary educational institutions for the use of public funds.

- An examination of the methods used by the Department to assess whether transferability of credits within the adult learning system avoids unnecessary repetition of content and duplication of student effort in a cost-effective manner.

Accounting for results

Recommendation No. 7

It is recommended that the Department of Advanced Education and Career Development continue to work with post-secondary educational institutions to develop a system which links educational outputs and costs to expected effects.

The scope of the examination done by my Office was to determine whether there is a system in the public post-secondary education

sector to ensure that funds which have been provided can be linked to outputs and their effects. A system which provides understandable, relevant, reliable and comparable information is invaluable to resource allocation decisions. The main conclusion drawn from this examination is that the Department and the post-secondary institutions should improve the system to measure the results obtained with the funds provided to the post-secondary education sector.

I believe that the Department's initiatives of developing key performance indicators is a step in the right direction. However, for these indicators to provide a context for what is desired, the sector should develop benchmarks in terms of educational quality and cost. Benchmarks such as desired cost per output and program completion rates should be incorporated in the institutions' business plans. Periodic reporting by the institutions should be in a format which will facilitate a comparison of actual to planned performance. In this way, the Department and the institutions can promote the efficient use of resources.

Transferability of credits

It is recommended that the Department of Advanced Education and Career Development, in conjunction with the Alberta Council on Admission and Transfer, and the post-secondary education sector develop a system to assess whether transfers of credits between post-secondary educational institutions in Alberta are meeting their expectations in a cost-effective manner.

The Alberta Council on Admission and Transfer is a 14-member independent body which reports to the Minister of Advanced Education and Career Development. It was established in 1974 with the primary goal of providing leadership and direction to improve educational opportunities for Alberta students through inter-institutional transfer of relevant course credits. The Council is expected to promote economy and efficiency in the delivery of adult education. The Council facilitates inter-institutional consultation and mediation, publishes information, and does applied research on transfers of credits.

The sector does not have sufficient information to assess whether the present level of course credit transfers between post-secondary educational institutions is appropriate, or how it can be improved. The Council, the Department and the post-secondary education sector have not established annual expectations for the transfer system. Nor is there a system to determine the costs of repeating previous relevant course work of transfer students. Therefore, it is not possible to determine if the transfer system is producing the desired results in a cost-effective manner.

For instance, information published by the Council regarding enrolments for the 1993-94 year indicated that 9,170 students transferred between post-secondary institutions in Alberta. It is unclear whether course credits obtained by students at an institution are recognized by the institution to which the students transferred. Through transfer agreements, the Council has facilitated recognition by universities of certain courses completed at colleges and technical institutes. However, there are no agreements which enable recognition of relevant academic credits by colleges and technical institutes. Also, credits obtained at a college or a technical institute may not be recognized at other similar institutions. In the absence of transfer agreements, students have to negotiate recognition of their relevant prior course work on an individual basis. I believe it would be more efficient if agreements were in place which would alleviate the need for individual assessments. The Province incurs an unnecessary cost to repeat the training of students whose relevant prior course credits are not recognized.

Provincial contributions

In the 1993-94 Auditor General's Report (page 25), it was recommended that the Department of Advanced Education and Career Development provide guidance to post-secondary educational institutions on the objective of the Province's capital funding in order to facilitate sector-wide performance measurement.

I am pleased to report that in May 1995, the Department issued accounting and financial policy guidance on the matter. The Department has now clarified that funds provided by it to the post-secondary educational institutions in the past were intended to fund the consumption of capital assets in program delivery. This guidance has stimulated useful discussions in the sector on how to manage and account for capital asset investments.

The policies issued in May 1995, were the result of co-operation between the Department, the Committee of Senior Business Officers of the Public Colleges and Technical Institutes, and my Office. I believe that through such co-operation we can improve the financial administration of the Province.

Other entities

Financial audits of the following were also completed for the year ended March 31, 1995:

Public Colleges Foundation of Alberta
Student Loan Fund

Matters related to Post-Secondary Educational Institutions

Amortization of capital assets

Historically, public post-secondary educational institutions have expensed the cost of capital assets when the assets were acquired, rather than when the assets were consumed. In other words, there was no recognition that investments in capital assets provide benefits over their useful lives. As a result, the annual operating results did not reflect the true cost of programs. Therefore, in management letters to post-secondary institutions, it was recommended that the institutions amortize their capital assets in accordance with generally accepted accounting principles.

I am pleased that in May 1995, the Department issued a Capital Assets policy which required institutions to amortize capital assets, and that as at March 31, 1995 all Provincially owned universities and The Banff Centre had complied with this policy. The Southern Alberta Institute of Technology amortized its capital assets in its June 30, 1994 financial statements, and I understand that all Provincial colleges and the Northern Alberta Institute of Technology will amortize capital assets in their 1995 financial statements.

Reserves appropriated from a deficit

The change in accounting policies for vacation pay accrual and the recognition of the pension liability disclosed historical accumulated operating deficits of a number of post-secondary institutions. However, some of these institutions subsequently created or increased their accumulated deficits as a result of transfers to reserves.

Institutions appropriate surplus funds to reserves for the purpose of designating amounts for future events or activities. Generally accepted accounting principles give boards the prerogative of appropriating monies to reserves. However, the Canadian Institute of Chartered Accountants Handbook, in all cases, refers to appropriations from "surplus". Nowhere does the Handbook mention appropriations from deficit, presumably on the basis that it is illogical to appropriate something from nothing. Appropriating monies from a deficit, or creating a deficit through appropriations, results in overstatement of both reserves and deficits.

It was therefore recommended to a number of institutions that they not create or increase deficits through appropriations to special purpose funds or reserves. Most of the institutions indicated that they wanted guidance on this matter from the Department. In May 1995, the Department revised its Fund Balance and Reserves policy which clarified that reserves may be established and maintained only if supported by net assets. I am, therefore, reviewing the appropriateness of reserve accounting policies used by post-secondary institutions during the current audit period.

Athabasca University
year ended March 31, 1995

In addition to the annual financial audit, my staff completed financial audits of the following for the year ended March 31, 1995:

Athabasca University Development Institute
Athabasca University Foundation

Governance

Recommendation No. 8

It is recommended that the Governing Council review Athabasca University's management structure and reporting processes, and consider the information necessary to ensure that collectively they are consistent with effective governance.

Athabasca University, like all other post-secondary educational institutions, is facing challenges associated with delivering quality education in a cost-effective manner. Successfully meeting these challenges requires the University's Governing Council to establish structures, processes and information systems to facilitate effective governance.

The University has started a number of new ventures. For example, the University's Centre for Innovative Management offers a Master of Business Administration degree program in a non-classroom environment. The University also offers executive development seminars through an operating unit called Athabasca University Educational Enterprises. It was expected that the Governing Council would have defined responsibilities for these ventures, the reporting processes, and the information necessary to enable it to assess the viability of these ventures. However, this was not the case with either the Centre for Innovative Management or with Athabasca University Educational Enterprises:

<u>The Centre for Innovative Management</u>

The Centre for Innovative Management was formed in August 1993, and admitted its first students in September 1994. To oversee the Centre's operations, the Governing Council appointed a Board of Directors and employed two executive directors to manage the Centre's affairs. Although the Centre is intended to be financially self-sustaining, its operations to date have been substantially funded by the University.

Accountability of the Centre's management to the Governing Council of the University was not well articulated because the following matters, which are essential for effective governance, had

not been resolved prior to commencement of operations of the Centre:

- The responsibility of the Centre's Board of Directors for program delivery and reporting was not clearly defined. As a result, it was not clear whether the Board could enter into agreements without the approval of the Governing Council.
- The reporting responsibilities and the performance expectations of the Centre's two executive directors were not defined.
- There was no consistent understanding of whether the Centre had the authority to make decisions regarding academic appointments, or any other matters of an academic nature.

From its inception in August 1993 to March 31, 1995, the Centre received funds totalling $1.3 million from the University. These funds are to be repaid to the University commencing in the 1997 fiscal year. The Centre is to be self-funding after that date. At March 31, 1995 the Centre had an accumulated deficit of approximately $1.0 million.

At November 1994, the Centre had not developed its 1994-95 operating or capital budgets. Subsequently, a three year budget was developed. These budgets forecast a loss of $50,000 for 1995-96, net earnings of $1.2 million for 1996-97, and net earnings of $1.9 million for 1997-98. Some of the assumptions made for determining budgeted revenues and expenditures, however, appear unrealistic. In the event that the Centre is unable to attain its projected targets, it will be unable to repay the University's investment in the program. This, in turn, will effect the University's cash-flows.

<u>Athabasca University Educational Enterprises</u>

Athabasca University Educational Enterprises (AUEE) was set up in 1990 to offer business and management workshops and seminars. Since its inception in 1990, it has incurred total operating losses of approximately $1.0 million of which $575,000 relates to 1994-95. In 1994-95, approximately 35 workshops and seminars were held, but only about 25% of these were profitable. One seminar alone incurred a loss of $108,000.

AUEE did not have well developed planning, monitoring and reporting processes. No overall objectives or specific goals were set, nor were any budgets prepared against which to compare actual performance. Further, those responsible were not held accountable for the financial results.

An internal review by the University indicated that:

- Some contractors hired to provide marketing and administrative services had no relevant experience.
- Some contractors entered into unauthorized agreements on behalf of the University.
- Managers often circumvented established policies and procedures concerning contracting of services and personnel, supply acquisitions and the use of University funds for training of contract personnel.

On November 15, 1994, responsibility for AUEE was transferred from the University's Marketing and Communications department to the Finance department.

A plan describing the results to be achieved, actions to be taken, and by whom, and the estimated cost and performance targets are key ingredients in promoting organizational accountability. Actual results should be compared against such plans, and explanations provided for all significant differences.

Defining and costing outputs

In the 1993-94 Auditor General's Report (page 28), it was recommended that Athabasca University define and cost its outputs.

I am pleased to report that the University has developed a framework to identify its outputs, and is also developing a system to cost them. The University is working closely with other universities in Alberta to develop a set of key performance indicators applicable to the post-secondary education sector. The University is also developing a set of key performance indicators unique to distance learning.

I believe the University's initiative will result in improved information for management and accountability. I will monitor the progress of these initiatives.

The University of Alberta
year ended March 31, 1995

In addition to the annual financial audit, my staff completed financial audits of the following related organizations for the year ended March 31, 1995:

The Laser Institute
University of Alberta 1991 Foundation

Sponsored research activities

Recommendation No. 9

It is recommended that The University of Alberta improve its measuring and reporting of sponsored research activities.

The University's systems to quantify the cost and effect of sponsored research activities can be improved. Improved quantification of sponsored research would strengthen the accountability of researchers to funders and university management. It would also enable the University to report on the cost and effect of pursuing one of its major objectives.

The University annually receives approximately $90 million in grants from sponsors of research activities. The University also uses its own resources to support sponsored research. The significance of the amounts spent on research activities, and the need to obtain results, are two factors that underscore the need for an effective accountability framework. To attract funding from new as well as traditional sources, the University must be able to demonstrate technical and financial competence in the research field. This requirement emphasizes the importance of reliable and relevant information concerning research activities.

The University's *Research Makes Sense* initiative has raised the profile of research, both on campus and in the public eye. The University is presently designing new automated systems, and senior University administrators, in concert with research stakeholders, should capitalize on this opportunity to examine ways in which sponsored research administration can better harmonize the objectives of researchers with financial management and accountability objectives.

The University should quantify the full cost of its sponsored research activities. Currently, this is not done. For example, the remuneration paid to principal researchers and research overhead costs are not included. This is because the objective of the current accounting system is to record how much of the funds provided by sponsors has been spent, and how much remains to be spent. Since sponsors do not usually fund the principal researcher's salary or overhead costs, these costs are not recorded as sponsored research expenditures.

Knowing the cost of the support provided by the University for its research objectives would promote informed resource allocation decisions. More importantly, if costs were related to the results obtained, the cost effectiveness of this activity would be evident to researchers, University management and those who fund the research.

Since research is a major objective of the University, I believe it should report on the cost and effect of the sponsored research undertaken and its future intentions in a manner that facilitates an understanding of this important activity. I believe the University's Annual Report would be the logical medium to communicate such information.

Alberta Microelectronic Centre
year ended March 31, 1995

Salary and benefits disclosure

It is recommended that the Alberta Microelectronic Centre include in its annual financial statements the salary and benefits disclosure information required by legislation.

Alberta Microelectronic Centre (AMC) is a not-for-profit company, incorporated under the Alberta *Companies Act*. Its corporate structure consists of two members - the Chairman and the President of the Board of Governors of The University of Alberta. This means that AMC is controlled by the University, and accordingly, pursuant to section 1(1)(n) of the Financial Administration Act, AMC is a Provincial corporation.

Alberta Treasury Board Directive 01/94, *Salary and Benefits Disclosure Directive*, requires all Provincial organizations to include in their annual financial statements information on the salaries and benefits received by senior officers, executives, managers and other staff. This is to ensure that users of the statements, including the Public Accounts Committee, receive useful accountability information about salary and benefits costs.

Management and the Board of AMC contend that the *Financial Administration Act* does not apply to AMC because it is not a Provincial corporation within the meaning of that Act. I have obtained a legal opinion, however, that AMC is a Provincial corporation subject to certain provisions of the *Financial Administration Act*. Those provisions include the requirement to disclose salary and benefits information in its annual financial statements.

As AMC's 1995 financial statements do not include the required salary and benefits information, my Auditor's Report on the financial statements includes a paragraph advising readers that AMC has not complied with the Treasury Board Directive relating to salary and related benefits costs.

I am informed that AMC intends to provide the required disclosure in its 1996 financial statements.

Telecommunications Research Laboratories
year ended March 31, 1995

Salary and budget disclosure

Recommendation No. 10

It is recommended that Telecommunications Research Laboratories disclose in its annual financial statements the salary and benefits information required by the Treasury Board and the comparative budget information prescribed by the Provincial Treasurer.

Telecommunications Research Laboratories (TRLabs) is a not-for-profit company, incorporated under the Alberta *Companies Act*. Its corporate structure consists of three members - the Chairman, the President, and the Governors of The University of Alberta. This means that TRLabs is controlled by the University, and accordingly, pursuant to section 1(1)(n) of the Financial Administration Act, TRLabs is a Provincial corporation.

Alberta Treasury Board Directive 01/94, *Salary and Benefits Disclosure Directive*, requires all Provincial organizations to include in their annual financial statements information on salaries and benefits received by senior officers, executives, managers and other staff. This is to ensure that users of the statements, including the Public Accounts Committee, receive useful accountability information about salary and benefits costs.

The Alberta Treasury Department also requires financial statements to include the organization's annual budget for revenue, expenditure, and cash flow. This is to facilitate comparison of planned and actual results.

Management and the Board of TRLabs contend that the *Financial Administration Act* does not apply to TRLabs because it is not a Provincial corporation within the meaning of that Act. I have obtained a legal opinion, however, that TRLabs is a Provincial corporation subject to certain provisions of the *Financial Administration Act*. Those provisions include the requirement to disclose salary and benefits and budget information in its annual financial statements.

As TRLabs' 1995 financial statements do not include the required salary, benefits and budget information, my Auditor's Report on the financial statements includes a paragraph advising readers that TRLabs has not complied with the Treasury Board Directive relating to salary and related benefits costs, and with instructions issued by Alberta Treasury relating to the disclosure of budget information.

The University of Calgary
year ended March 31, 1995

In addition to the annual financial audit, my staff completed financial audits of the following related organizations for the year ended March 31, 1995:

The Arctic Institute of North America
University of Calgary Foundation
University Technologies International Inc., and
The University of Calgary Olympic Oval/Anneau Olympique.

The University of Lethbridge
year ended March 31, 1995

In addition to the annual financial audit, my staff completed the financial audit of the **University of Lethbridge Foundation** for the year ended March 31, 1995.

The Banff Centre for Continuing Education
year ended March 31, 1995

None of the matters reported to management at the conclusion of the annual financial audit were selected for inclusion in this report.

Fairview College
year ended June 30, 1994

In addition to the annual financial audit, my staff examined the systems used by Fairview College to plan, monitor and report its activities and achievements. The examination included a review of a program costing project. The project, conducted by Alberta's four agricultural colleges, was designed to pilot test the program costing methodology developed by Alberta's publicly funded colleges and technical institutes and the Department of Advanced Education and Career Development as part of the initiative to develop key performance indicators for the system.

It should not be assumed that a recommendation similar to the one following would not apply to other institutions where such work was not carried out. Other institutions may be able to benefit from examining their own practices to determine whether the recommendation I have made is relevant to their environments.

Results-oriented reporting

It is recommended that Fairview College improve its information systems to facilitate the allocation of resources by linking costs to expected outputs and their effects.

Fairview College offers a wide range of career training, trade, apprenticeship, academic upgrading and college preparation programs in northwestern Alberta. These programs are funded by annual Provincial grants of approximately $12 million. Tuition and other revenue sources generate approximately another $5 million.

Financial targets in the College's three year business plan focus on inputs rather than on outputs, and changes in revenues and expenditures are presented in the context of their impact on operating activities, rather than on desired effects. The plan does not define the results the College expects to achieve in terms of specific outputs, such as, for instance, the number of graduates by program. The Board of Governors and management need a results-oriented plan to determine whether expectations have been met or exceeded.

The College participated in a project with the three other agricultural colleges to determine program costs for 1993-94. The project report indicated that large cost variations occurred by program and location. It was also noted that the inclusion of overhead costs in programs or ancillary operations can dramatically change the financial picture of an operation. For example, ancillary operations at the College showed a contribution of $164,000 before considering overhead cost, and a loss of $250,000 after the inclusion of such costs. Such information is especially critical in managing cost-recovery programs.

The College needs to incorporate full cost reporting in its information systems. This would assist management in evaluating the reasonableness of costs incurred, relative to the results expected.

I acknowledge that the College is making progress towards recognizing its full costs. I am advised that the College plans to amortize its capital assets starting in the June 30, 1995 financial statements. Also, the College, in consultation with other post-secondary educational institutions, is developing key performance indicators that will be used to measure and evaluate the College's performance.

Grande Prairie Regional College
year ended June 30, 1994

In addition to the annual financial audit, my staff examined the systems used by Grande Prairie Regional College to plan, monitor, and report its results.

It should not be assumed that similar recommendations to the ones following would not apply to other institutions where such work was not carried out. Other institutions may be able to benefit from examining their own practices to determine whether the recommendations I have made are relevant to their environments.

Program costs

It is recommended that Grande Prairie Regional College develop information systems to link the resources consumed with expected outputs and their effects.

Monthly financial information on costs is provided by functional area, such as "instruction" and "college services". This information may be useful for planning and monitoring the College's functions or activities. However, the Board of Governors and management need program cost information to evaluate program performance, and to make resource allocation decisions among programs.

As a first step, program costs for each of the Diploma, University Transfer, High School Equivalent, and Trades/Technical programs could be determined. Program costs should be calculated on a semester basis, or at least annually, and linked to the number of full time equivalent enrolled students (FTEs) for each program, to arrive at the cost per FTE for each program. Management could then assess the reasonableness of costs relative to the effects expected. In this way, the College would be better able to relate its outputs to the resource allocation decisions made.

International education initiative program

It is recommended that the Board of Governors of Grande Prairie Regional College evaluate the international education initiative program to establish whether it is achieving desired results.

In 1994, Grande Prairie Regional College began recruiting international students. The main objective of the international education initiative program, according to the College, is "to reduce dependence on government grants by selling our training and education services for a profit." The College hoped to use the profits generated by this program to offset potential reductions in funding due to penalties assessed by the government because of reduced enrolments. Based on the results to date, the program is increasing costs, rather than reducing the College's overhead costs. Also, the number of students participating has not met expectations.

While I recognize that start up costs and a period of time are needed to introduce a new initiative, I believe that the College should reassess the longer term expectations of this initiative.

The program's original plan intended that international students would contribute about $2,700 each towards the College's overhead expenses. If enrolment reached 100 students, as was expected in 1994-95 from one country alone, the program would have contributed $270,000. In 1994-95, its first year of operations, the international education program generated revenues of approximately $23,000, and cost the College an additional $65,000 in instruction, travel and marketing expenses. An amount of $42,000 had already been spent for program start up costs. To the end of June 1995, this initiative had consumed $84,000 of the College's resources.

Financial information

It is recommended that Grande Prairie Regional College improve the quality of financial information provided to the Board of Governors. It is also recommended that the completeness and accuracy of information used by management to predict cash requirements be improved.

The Board of Governors and management of Grande Prairie Regional College need appropriate information in order to objectively assess the College's operations. In order for the information to be useful, it must be relevant and reliable. However, the Board and management are not always provided with adequate information:

- Monthly financial reports provided to the Board show amounts for ancillary operations on a net basis. Revenues, expenditures, gross profit on sales, and operating costs were not reported to the Board.

- The monthly reports included net revenue from duplicating services. All duplicating services revenue, however, results from interdepartmental charges. The College's financial reporting system includes these transactions as ancillary services revenue and departmental expenditure. Reporting in this way implies that duplicating services revenue helps to reduce the College's total overhead costs. Duplicating services do not generate revenue.

- Cash flow forecasts are used to predict cash requirements. Near the end of fiscal 1994-95, the College forecast a shortfall in cash resources for August 1995, and arranged for additional financing. However, cash required to settle certain investing transactions entered into in 1994-95, but requiring payment in 1995-96, was not included in the cash flow forecast.

Reservations of opinion

The Auditor's Report on the financial statements of the following institutions contained reservations of opinion because, as discussed below, the presentation of financial position was, in my opinion, inappropriate:

Year ended June 30, 1994

Grant MacEwan Community College
Mount Royal College
Northern Alberta Institute of Technology

The recognition of accrued vacation pay and pension liabilities by the above institutions resulted in their financial statements disclosing operating deficits at June 30, 1994. However, these institutions chose to report an "operating surplus balance" before accounting for the effect of accrued vacation pay and the pension liability. In my opinion, this presentation was inappropriate as it implied that the liabilities relating to vacation pay and the pension liability were not incurred in the normal course of operations.

In May 1995, the Department of Advanced Education and Career Development issued accounting and financial policies on the treatment of vacation pay, and pension liabilities. These policies have effectively dealt with my concerns.

Department of Agriculture, Food and Rural Development
year ended March 31, 1995

Guidance to reader

Audits conducted in recent years at the Department of Agriculture, Food and Rural Development have focused on the Department's planning process. These audits have generally confirmed that the Department has a strong planning process.

I am pleased to note that the Department has taken steps to further improve its accountability, and accepted the recommendation made in the 1992-93 Auditor General's Annual Report (page 12), which discussed ways in which the quality of Annual Reports could be improved.

In its 1993-94 Annual Report, the Department reported on its achievements during the year, and the extent to which those achievements met goals. As the Deputy Minister noted in his introduction to the Annual Report, "*... we have presented the information in a manner that begins to permit the performance of the department to be measured. As the business planning process evolves and methods of measuring output improve, we expect future annual reports to better implement the recommendations made by the Auditor General.*"

Scope of audit work

In addition to the annual financial audit, the following work was completed:

- A review of plans for the proposed whole farm support program.
- An examination of the financial systems established for the Agriculture, Food and Rural Development Revolving Fund.

Safety net criteria

Recommendation No. 11

It is recommended that the Department of Agriculture, Food and Rural Development use the criteria developed for the whole farm safety net program to assess the appropriateness and effects of other farm income support programs.

In consultation with industry, the federal government, and other provincial governments, the Department is planning to implement a "whole farm safety net program". The program's goal is to strengthen industry's ability to manage risk and uncertainty. As part of the consultation process with industry, criteria were established to identify the critical aspects of a comprehensive safety net program. These criteria could also be used to evaluate the need for any support programs that remain after the implementation of the whole

farm program, as well as any farm income support programs that might be considered in future.

For example, the Alberta Farm Fuel Distribution Allowance (AFFDA) currently provides producers with a rebate of six cents per litre on diesel fuel purchases. However, support of this nature may no longer be needed because coverage under the whole farm safety net program should be adequate.

The Department estimates that the AFFDA program will cost $30 million annually for the next three fiscal years. A review of the appropriateness of this program could help to ensure the best allocation of available support funds.

Agriculture Financial Services Corporation

year ended March 31, 1995

Effective April 1, 1994, the Alberta Agricultural Development Corporation and the Alberta Hail and Crop Insurance Corporation merged to form the Agriculture Financial Services Corporation.

Scope of audit work

In addition to the annual financial audit, my staff completed an examination of the systems used by the Corporation's lending division to manage Beginning Farmer Program loans.

Verification of information

Recommendation No. 12

It is recommended that the Agriculture Financial Services Corporation use risk-based techniques to identify which information obtained to determine insurance coverage, premiums and claims needs to be verified.

The following two examples illustrate the need for the Corporation to focus on identifying information that is likely to be incorrect.

Reliability of planned production information

Obtaining and retaining reliable information about each farmer's operations and planned production is vital to the proper administration of the Corporation's insurance programs. Information received from farmers detailing the numbers of acres and types of crop planted is used to calculate premiums payable, to determine coverage, and estimate target revenue.

The Gross Revenue Insurance Plan (GRIP) program is to be phased out in 1996. The objective of the program was to provide farm income stability over time. In other words, the program premiums

paid out of farm income in good years should finance payments to farmers in poor years. The program allows farmers to terminate by giving three years notice, or to terminate immediately if they repay all amounts received by them in excess of premiums paid. Without this requirement, farmers would tend to join when prices were low and leave when prices were high.

When the GRIP program was first introduced, support prices were higher than market prices. Farmers who joined the program could normally expect to receive much more than they paid in. This, allied with bad weather conditions, contributed to GRIP accumulating a deficit of $255 million in its first two years of operation.

Since then, however, support prices have gradually decreased while market prices have gradually increased. Compared to when the program began, farmers cannot expect to claim unless they experience a very poor crop. As a result, GRIP has more than recovered the deficit it accumulated during the first two years of operation.

The changes in market conditions described above give rise to changed risks for the Corporation. The risk of the Corporation receiving incorrect seeding and production data changed as market conditions changed. In the early years, farmers benefited if their seeded acres were overstated and their production was understated. By the 1994 crop year, the opposite was true. The Corporation's procedures for checking the correctness of this data, however, did not respond to these changing risks.

With strong market prices, it was reasonable to expect that seeded and, therefore, insured acres for 1994 would be similar to 1993, or might even increase. For the 1994 crop year, however, insured acres decreased by approximately one million acres (7.2%). Audit examination of a sample of cancelled contracts revealed many situations where the farmer had leased the land to another farmer who was not in the GRIP program. It was noted, however, that in many of these situations, the first farmer was still insuring the crop, under another program, against hail damage. This indicates that the first farmer retained an economic interest in the crop, raising a question as to whether the lease arrangement was a device to avoid insuring under GRIP.

My staff also examined a sample of 250 contracts for farmers who had declared that no acres were seeded to insurable crops. This revealed two situations where premiums should have been charged, as insurable crops had been seeded. Two further situations where it appeared that premiums should have been charged are now under investigation by Corporation staff.

Although GRIP is to be phased out in 1996, some of the information accumulated during the program's life will be used in the administration of other programs, perhaps even in the program that will replace GRIP. To this end, the Corporation needs to be able to identify situations where farmers appear to give conflicting information about the same crop for different insurance programs. This would also help ensure that all premiums due to the Corporation are invoiced.

The Corporation would benefit if, prior to each crop year, it assessed the changing risks associated with the reliability of information used to determine insurance coverage and to calculate premiums.

<u>Yield verification and measurement</u>

Reported yields have a direct impact on the coverage farmers receive on future crop insurance policies and, to a lesser extent, on area average yields. If farmers overstate their yields, coverage adjustments for future years will be inflated, thereby allowing higher production levels to be insured than are justified by historical experience. As the Corporation moves to reduce inspection costs by reducing the number of farmers whose yields are measured, it is critical that it develop methods of identifying those farmers whose yields are at the greatest risk of being reported incorrectly. In addition, adjusters must be aware of all circumstances that could affect the measurement of yields.

Currently, individual farmer's yields are compared to area average yields to identify situations where reported yields have been inflated by, for example, including crops originally intended as greenfeed or silage in the reported production. However, area average yields can vary substantially for such reasons as seed variety, weather patterns, and fertilization and weed control programs. Even where an adjuster carries out a post-harvest measurement, it can be difficult to determine what effect each of these variables has had on a farmer's yield. There is a risk that reported yields may be accepted as reasonable when, in fact, they are not.

During 1994-95, there were situations where inaccurate information was used to calculate yields. Instances were observed, for example, where canola production had been measured and the yields considered reasonable. The adjusters, however, were unaware that hail claims had previously been submitted for these crops. As it happened, volunteer canola harvested from fields planted to another crop was included in the farmers' reported production, resulting in the yields exceeding area averages. The errors were not detected by Corporation staff with the result that the farmers' coverage

adjustments were inflated, which would have allowed them to insure unduly high yields in future years.

A risk model capable of predicting yields would help in identifying farmers whose reported yields appear unreasonable. Risk assessments, however, should not be limited to identifying abnormal yields merely by comparing reported yields to coverages or area averages. They should also incorporate factors such as area weather conditions, known changes in cropping practices, changes in the number of acres seeded, and previous experience of inaccurate reporting. Special attention might also be given to situations where farmers have planted insured and non-insured acres of the same crop. Risk assessments that take all these factors into account could help to ensure that harvested production is accounted for appropriately, and that coverage adjustments for future years are calculated correctly.

It is understood that the Corporation's Yield Verification Committee has also made recommendations focusing on identifying significant yield differences between years.

Beginning Farmer Program

It is recommended that the Agriculture Financial Services Corporation define measurable objectives for the Beginning Farmer Program against which the performance and costs of the Program can be measured.

The general objective of the Beginning Farmer Program is to help new farmers establish and maintain viable farms. A beginning farmer can receive a loan up to a maximum of $200,000. The loan is at a fixed interest rate of 9% for the term of the loan. However, for the first five years, an interest relief benefit of 3% per year is available to the beginning farmer. There are in excess of 9,000 loans currently outstanding under this Program totalling approximately $744 million.

The Corporation does not have adequate information to determine to what extent the Program objective is being met in a cost-effective manner. Currently, management uses the level of loan arrears as an indicator of the Program's performance. This indicator, however, has its limitations. While loan arrears can indicate that a farm is not viable, lack of arrears is not a reliable indicator that a farm operation is viable. This is because some borrowers may subsidize their farm operations with off-farm income and may have little farm income.

The Corporation anticipates that farmers will go through a development period of up to ten years. During this period, there should be a decreasing reliance on off-farm income to sustain the

operations. Therefore, in determining whether a farm operation is viable, it may be necessary to use several definitions, or an evolving definition of "viable farm". For example, the borrower's expected progress could be documented in a development plan. Actual progress could then be measured against planned progress to determine Program success.

Almost any method of measuring viability will involve increasing the amount of information obtained from borrowers. Currently, in most instances, there is no information obtained after the interest benefit period has expired. Therefore, it is difficult to measure whether a farm's development has progressed to self-sufficiency as expected, or if the operations are supported by off-farm income. Identifying situations where the operation has not progressed as anticipated, and determining the reasons therefor, will help the Corporation to determine changes that are required to the Program.

The number, or percentage, of borrowers who achieve economic viability under the Beginning Farmer Program is a worthwhile performance indicator. However, to evaluate cost-effectiveness, financial and performance information must be brought together in a meaningful way. Applying this to the Beginning Farmer Program, a useful accountability report would show the Program's outputs (the help or major services the Corporation provides to the farmers such as providing advice, pre-screening of applications, and monitoring activities), the cost of providing those services, and the effects produced (the number or percentage of viable farms).

Loan monitoring

It is recommended that the Agriculture Financial Services Corporation retain better evidence to support evaluations and decisions pertaining to loans, particularly loans to borrowers who are experiencing loan repayment difficulties.

Loans officers are responsible for loans from approval through to the collection of outstanding balances. With improved financial information, loan officers can better monitor the ability of borrowers to repay their loans.

After the first five years, borrowers are not normally required to submit financial information. However, when loans are in arrears, it is prudent to require the borrower to provide financial information. The information obtained can be used to monitor and assess whether the default is likely to be temporary. If the situation is determined not to be temporary, action can be taken to minimize losses. Information obtained can also be used to assist the loans officer in providing advice or counselling to the borrower on the alternatives available to reduce the risk of non-repayment.

A sample of loan files examined during the audit revealed that some files lacked information needed to evaluate the borrower's ability to make repayments. Furthermore, on loans that are experiencing difficulty, loans officers sometimes accept commitments by borrowers, and defer the repayments without first obtaining evidence that the borrowers have the ability to meet their commitments. Some files also lack assessments of whether an arrears situation is likely to be temporary, or evidence that work-out plans have been agreed.

Compliance with generally accepted accounting principles

Inadequate accounting systems are still preventing the Corporation from properly accounting for interest accrued on loans, where collection is not reasonably assured, in accordance with generally accepted accounting principles.

The Corporation reports that it plans to implement a loan accounting system in 1997 that will enable it to report loan interest revenue in accordance with generally accepted accounting principles.

Contract interpretation

In the 1993-94 annual report (page 36), the Auditor General recommended that the Agriculture Financial Services Corporation avoid paying incorrect claims by ensuring that its operating practices are consistent with the terms and intent of the crop insurance contract. This recommendation was based on observations that the Corporation was assessing claims based on the date the farmer reported the loss, instead of the date the loss occurred. By deferring reporting losses until after July 1, farmers could, in some cases, double the amount of their claim.

The Corporation has since amended the crop insurance contract to allow claims to be assessed based on the date the farmer reports the loss.

Other entities

Financial audits of the following were also completed for the year ended March 31, 1995:

Alberta Agricultural Research Institute
Alberta Dairy Control Board

Department of Community Development
year ended March 31, 1995

None of the matters reported to management at the conclusion of the Department's annual financial audit were selected for inclusion in this report.

Other entities

Financial audits of the following were also completed for the year ended March 31, 1995:

The Alberta Historical Resources Foundation
Alberta Multiculturalism Fund
Community Development Revolving Fund
Glenbow-Alberta Institute
The Government House Foundation
Historic Resources Fund, and of the

Alberta Sport Council and
The Recreation, Parks and Wildlife Foundation for the three month period ended June 30, 1994, and of the

Alberta Sport, Recreation, Parks and Wildlife Foundation for the nine month period ended March 31, 1995

Department of Economic Development and Tourism
year ended March 31, 1995

None of the matters reported to management at the conclusion of the Department's annual financial audit were selected for inclusion in this report.

Alberta Tourism Education Council
year ended March 31, 1995

Compliance with legislation

It is recommended that the Alberta Tourism Education Council restrict its operations to programs and activities that relate to the tourism and hospitality industries as required by legislation.

If management of the Alberta Tourism Education Council intends to pursue programs and activities outside of the tourism and hospitality industry, it is recommended that legislative amendments be sought to widen the scope of the Council's programs and activities.

During the year, the Alberta Tourism Education Council financed the provision of services to, and received revenue from, two organizations outside of the tourism and hospitality industries.

I obtained a legal opinion which concluded that:

- the Council's mandate is limited by section 3 of the Tourism Education Council Act to programs and activities relating to the tourism and hospitality industries.

- the two organizations were outside the tourism and hospitality industries and therefore outside the scope of section 3 of the Act.

After discussing this legal opinion with the Department and the Council's management, agreement was reached to disclose these conclusions in a note to the financial statements. I also drew attention to this disclosure in my Auditor's Report on the financial statements.

Alberta Research Council
year ended March 31, 1995

Royalty and licence fee revenue management system

Recommendation No. 13

It is recommended that the Alberta Research Council develop a system that assists the timely collection of royalties and license fees.

The Research Council needs to obtain more comprehensive and timely information about the operations of organizations with which it has joint venture contracts and technology licensing agreements, and to ensure that it is receiving the royalties and license fees it is due.

In recent years, the Research Council has re-defined its strategic focus. Less of its work now involves government departments. Instead, in pursuing the goal of performing applied research and promoting technology, the Research Council is entering into agreements with private sector organizations. Many of these agreements specify that the Research Council is to receive royalties or licence fees based on the continued use or commercialization of the technologies developed.

The Research Council is anticipating that royalty and licence fee revenues will increase substantially in future years. Business plans show these revenues increasing from $240,000 in 1994-95 to over $3 million in 1996-97. Achieving these increases is important, especially in light of the Research Council's continuing efforts to become less dependent on government funding.

The agreements require clients to provide the Research Council with performance reports and other information needed to calculate royalties and licence fees. Currently, very few clients are providing this information, and almost no efforts are made by the Research Council to obtain it. In effect, the Research Council relies on the integrity of its clients to remit royalties and licence fees correctly and on time.

It is probable that royalty and license fee revenue is being foregone. For example, Research Council staff learned that one client had made sales more than a year ago that should have attracted royalty, yet none had been received. Belated efforts then began to collect the amount due. In another case, a cheque was received which, because royalty revenue was not being monitored and anticipated, was not recognized as royalty until the client was contacted.

One Research Council goal is for each research venture to eventually return royalties or license fees in excess of the Research Council's original contribution to the venture. For this to happen, intellectual property must be commercialized successfully, and clients must remit all royalties and license fees due.

The Research Council has since responded that it is developing a royalty management system that will ensure that the information needed to determine and collect royalties and licence fees due is obtained.

Other entities

Financial audits of the following were also completed for the year ended March 31, 1995:

Alberta Heritage Foundation for Medical Research
Alberta Motion Picture Development Corporation
Alberta Opportunity Company
Chembiomed Ltd.
Economic Development and Tourism Revolving Fund, and

Alberta Intermodal Services Ltd. for the year ended December 31, 1994

Department of Education
year ended March 31, 1995

Guidance to reader

Education in Alberta is delivered primarily through a network of schools within publicly funded school jurisdictions. Authority over these jurisdictions is given to publicly elected school boards.

The recommendations that follow were previously reported in the 1993-94 annual report of the Auditor General. All the recommendations relate to possible improvements in the information reported by school boards to the Department. I am given to understand that the Department is in the process of changing the reporting requirements for school boards, with the intention of implementing these changes in the next reporting period.

Accountability of the education system

In the 1993-94 annual report (page 47), the Auditor General stated that an accountability framework for the education system should be reflected in legislation. This framework should:

- Require business plans and performance information, defined in regulations, for each school board.

- Require that audited financial statements for each school board be consistent with generally accepted accounting principles.

- Require the Minister to table in the Legislature a combined financial statement on the results of school board operations showing budget and actual information.

- Require the Minister to table an annual report in the Legislature on the cost and effectiveness of the education services provided. The contents of the annual report should be defined in regulations.

The Government Accountability Act provides the legislative basis for future accountability reporting by the regional school boards. The Department is planning to report on the performance of school boards using a framework similar to that listed above. However, I understand that the Department does not intend to consolidate school boards' business plans and annual reports in the Ministry business plan or annual report. I will review the Ministry business plan and annual report when available to assess whether, in my opinion, the performance of school boards is adequately reported.

Costs of education

Recommendation No. 14

It is recommended that the Department of Education require that financial statements for each school board be prepared in accordance with generally accepted accounting principles.

In the 1993-94 annual report (page 48), the Auditor General stated that school boards' financial statements do not include the amortization of capital assets. In addition, some boards accrue costs for goods ordered but not yet received.

Requiring boards to report financial information in accordance with generally accepted accounting principles will promote financial consistency and comparability between school boards. It will also ensure that accurate and complete costs of education are reported.

The Department is developing prototype school board financial statements. In a recent letter to the Deputy Minister, I outlined some areas of concern pertaining to the reporting requirements regarding pension costs, program costing, contingencies, commitments, subsequent events and related party transactions. I have also accepted an invitation to have a member of my staff participate in the committee that is developing the prototype financial statements.

Cost presentation

Recommendation No. 15

It is recommended that the Department of Education require school boards to include in their financial statements information that links costs with results.

In the 1993-94 annual report (page 49), the Auditor General stated that the current presentation of the financial results of school boards does not enable a comparison of the costs incurred to the achievement of certain educational results.

School boards currently present costs in broad functional expenditure categories including instruction, operation and maintenance, administration and transportation. With this kind of presentation, it is not possible to relate costs incurred to the results generated by the educational system.

The Department has developed an *Accountability in Education Policy Framework* document, and a common format for school board performance measurement reporting is planned for the 1995-96 school boards' Annual Education Results Reports. I will review these reports when available to assess whether the linkage between costs and results is adequate.

Special needs program expenditures

Recommendation No. 16

It is recommended that the Department of Education require school boards to provide information which relates special needs program expenditures to services delivered and the number of students served.

In the 1993-94 annual report (page 50), the Auditor General stated that the Department cannot determine how funds for special needs education have been spent.

Current school board annual reporting does not relate special needs education expenditures to services delivered and the number of students served.

Consistent financial reporting that relates costs to the level of services provided and the number of students served, will enable the Department to evaluate the efficiency of the program. It should also act as a suitable base for assessing future funding requirements.

The definition of special needs education has changed within the Department's new framework for funding school boards. Only severely handicapped students are now covered by special needs funding. Requirements for school boards will be revised to require disclosure of special needs funding, the expenditures incurred to deliver the services, the number of students served and the services provided.

I understand that the reporting changes are to be implemented starting with the school boards' fiscal years ending August 31, 1996. I will review these changes when implemented to ensure they address my concerns.

Alberta School Foundation Fund
period ended March 31, 1995

The Alberta School Foundation Fund commenced operations on May 25, 1994. It assumed the assets and liabilities of the School Foundation Program Fund, which was dissolved on that date.

Audit Board

Recommendation No. 17

To prevent misunderstanding, it is recommended that the Minister of Education (responsible for the School Act) and the Provincial Treasurer (responsible for the Financial Administration Act) clarify the role and responsibilities of the Alberta School Foundation Fund Audit Board, so as to avoid duplicating the expenditure safeguards of the Financial Administration Act and the functions of the Auditor General.

The School Act states that "The Alberta School Foundation Fund Audit Board shall ensure that money in the Alberta School Foundation Fund is paid only to boards."

It is unclear from the School Act how the Alberta School Foundation Fund Audit Board (Audit Board) will carry out its mandate, and further, whether it is intended to discharge a management role or an audit role. Either role presents substantial difficulties.

If it is intended that the Audit Board discharge a management role, it would duplicate the expenditure safeguards in the Financial Administration Act (FAA).

Money in a statutory fund can be spent only for the purposes specified in the governing statute. Section 159.1 of the School Act allows money in the Alberta School Foundation Fund (the Fund) to be paid only to school boards. It follows therefore that a payment to anyone other than a school board would be unauthorized and thus illegal.

The safeguards to prevent unauthorized payments from the Fund (to persons other than school boards) are founded in Part 4 of the Financial Administration Act (FAA) (Disbursement of Public Money) and in particular sections 35 (disbursement control), 37 (expenditure officers), 38 (accounting officers), and 39 (qualifications). I am advised by my Counsel that these sections of the FAA have primacy over Section 159.1 of the School Act by reason of Section 2(1) of the FAA. The current legislative requirement to "ensure" that Fund monies are paid only to school boards, in my opinion, constitutes duplicative and unnecessary controls.

If it is intended that the Audit Board discharge an audit function, it would duplicate, though it could not supplant, the duties of the Auditor General. The Auditor General is required to issue an Auditor's Report to the Minister of Education on the annual financial statements of the Fund. In addition, the Auditor General is

required to report to the Legislative Assembly each case he has observed in which disbursements of public money have not been made in accordance with legislation. In the fiscal period ended March 31, 1995, no such instances were observed.

The Audit Board could better serve the interests of school boards, taxpayers and the Legislature if its objectives were defined to be more in line with those of an audit committee. It could then carry out such functions as reviewing with management the adequacy of internal controls, and meeting with the auditor to enquire as to the audit approach and any concerns or findings that have resulted from the audit.

Other entities

Financial audits of the following were also completed:

Education Revolving Fund - year ended March 31, 1995
Northland School Division No. 61 - year ended August 31, 1994
Teachers' Retirement Fund - year ended August 31, 1994

Department of Energy
year ended March 31, 1995

Background

Each year, the Department collects natural gas and byproduct royalties on behalf of the Province. These royalties exceed one billion dollars annually. On January 1, 1994, legislation came into effect which established a new gas royalty structure for the Province. According to the legislation the Department will prepare and issue monthly gas royalty invoices to each of the Province's approximately 700 gas royalty payers. Invoicing will be the main control mechanism for gas royalty revenues. The Department has not produced a gas royalty invoice for any production month from January 1994 to the present.

Historically, the gas royalty business has been extremely complex. The gas royalty regime which evolved through the 1970s and 1980s resulted in a system which required 450,000 separate filings annually. By the early 1990s, the volume and complexity of paperwork, in combination with downsizing in both government and industry, increased the risk related to the timely and accurate completion of routine processing. Simplification of the royalty regime offered a response to this risk. The Department estimated that simplification could reduce paper filings by 70%, thereby generating significant operational savings for the Department and a $25 million annual administrative savings for industry.

Simplification would also mean clearer business rules, fewer controversies, and less need for field auditing of royalty payors by Department staff to confirm the revenue flow. In October 1992, the Premier and the Minister of Energy announced their intention to simplify the gas royalty regime. Simplification proceeded under two major constraints:

- there was to be no material change to each individual gas royalty payer's burden, or to the total gas royalty collected by the Province on conversion to the new regime, and

- the transition cost for industry had to be kept to a minimum.

The Department began to plan a new computerized system called the Mineral Revenues Information System (MRIS) to manage the new gas royalty business. Technological advances such as client/server architecture and electronic data exchange offered the promise of reduced processing costs and improved client service. The simplification of the gas royalty regime and the development of MRIS were to proceed simultaneously; I refer to the combination of these activities as the MRIS Project. For the Department, initiating the MRIS Project was a first step in simplifying the Department's

revenue collection, including Crude Oil Royalty and Freehold Mineral Tax. In December 1992, consultants estimated that the MRIS Project and simplification of other royalty collection would cost $17 million to $20 million. This estimate did not include all related Departmental staff costs.

The Department did not properly plan or manage the MRIS Project. It failed to identify and adequately deal with many of the Project's risks.

The Department did not prepare either a strategic plan or an information strategy and plan prior to initiating the MRIS Project. These plans would have priorized the MRIS Project in the context of other Departmental initiatives and helped ensure that appropriate resources were available. Despite the size and importance of the MRIS Project, the Department did not separately identify the Project in its annual budget until 1995-96.

The Department decided that the Project would embrace high risk, leading edge computer information technology, thereby increasing development time because the database software selected was unproven and still under development. This necessitated additional technical support and training, and higher development costs. Plans should have identified the risks arising from using the new technology and provided alternatives if the technology proved unworkable.

In October 1993, contractors bid on the development of the Gas Royalty component of MRIS before the Department completed developing its detailed business requirements. This contributed to tendered bids ranging from $3.1 million to $8.1 million. A $3.3 million fixed price proposal was accepted and experience has shown that the lack of clarity in the definition of business processes led to friction between the contractor and the Department and to delays in development.

A project manager with the skills and experience required to guide the Project to completion should have been assigned at the commencement of the Project. The Department should also have developed a complete and detailed Project plan, essential for scheduling, resourcing, and controlling such a major development project. Due to its lack of experience and its decision not to develop the business rules for the new gas royalty regime in advance of the Project, the Department did not develop realistic timelines and resource requirements for the completion of work. As a result, the time and resources required for the Project were underestimated. In addition, because the Project lacked experienced

leadership, the Department failed to adequately define essential activities such as user acceptance testing.

Senior management within the Department could have employed a steering committee to review overall progress and ensure that all users' needs were being addressed. Senior management could also have made greater use of internal audit staff to provide assurance that the Project was progressing as the project manager reported.

The Department has made changes in the project management structure, and corrected many of the project management deficiencies noted above, with MRIS Project activities planned through June 1996. By that time, the Department estimates that total costs related to the Project will have reached $32 million. This estimate applies only to a gas royalty component for MRIS, and includes an amount for Department staff, which was not included in the original estimate.

As mentioned, MRIS has not yet produced a gas royalty invoice. Gas royalty payers continue to submit self-estimated monthly royalty payments to the Province. However, since the Department has not yet issued invoices for gas royalty, it does not have effective control over the revenue flow. According to the current MRIS Project schedule, the first invoice is to be created in late 1995, and invoicing is expected to be up-to-date by mid-1996.

Two of the recommendations that follow are intended to facilitate the Department of Energy's efforts in implementing an appropriate gas royalty revenue system.

Risks associated with the Mineral Revenues Information System

Recommendation No. 18

It is recommended that the Department of Energy periodically reassess the risks associated with continuing the development and implementation of the Mineral Revenues Information System.

As indicated above, the Department must issue invoices to achieve effective control over gas royalty and to comply with legislation. However, the Mineral Revenues Information System has a history of failing to meet scheduled milestones, and the Department has not yet implemented MRIS and issued the required invoices.

The Department believes that MRIS is the only viable alternative available for calculating gas royalty invoices. While MRIS has shown potential in recent testing, it is not certain to produce accurate invoices within a reasonable timeframe and cost. In

addition, significant development effort is still required through June 1996 to complete certain components of the system.

The urgency to issue invoices should not prevent the Department from considering alternatives to MRIS. It should establish dates when it will formally assess the Project's status and evaluate other alternatives if necessary. Mounting costs and further delays to MRIS delivery may change the Department's current view that MRIS is the only viable alternative. One possibility is that the royalty revenue process be reconsidered, and consideration given to a system which does not rely on invoices to bill and collect royalties, at least in the short term.

Royalty simplification

Recommendation No. 19

It is recommended that the Department of Energy determine the extent to which it has achieved the intended royalty simplification initiatives, and complete its planning for further royalty simplification efforts.

As discussed earlier, the Department intended to simplify its royalty processes and started with gas royalty in its simplification efforts. Unfortunately, gas royalty simplification has not produced the anticipated benefits. Despite simplification efforts, the gas royalty business rules continue to be complex, and subject to misinterpretation by industry. The Department has not benefited from its technological upgrading, and other royalty simplification efforts have not progressed. Development, operating, and maintenance costs related to royalty systems have not declined as the Department continues to support and operate the original royalty system for Oil Royalty and Freehold Mineral Tax purposes.

The Department has recognized that new strategic planning is needed to address royalty simplification. The Department should analyze the risks, constraints, and opportunities related to the Department's royalty collection activities. It is possible that many of the Department's simplification objectives from 1992 are still legitimate, but a relaxation of constraints (see page 99) may be necessary to achieve true simplification. The planning and coordination required to achieve any newly defined objectives must also be improved. A complete strategic plan would ensure that internal and external parties understand the Department's major initiatives, timetables for development, and criteria for success.

Financial systems and reporting

It is recommended that the Department of Energy improve its financial systems and reporting processes to ensure accurate financial statements.

Beginning with the 1996-97 fiscal year, Ministries will prepare their own departmental and ministerial consolidated financial statements. The Department's financial systems must be ready to meet this challenge starting April 1, 1996. The Department needs to improve its accounting systems, year-end coordination, and financial reporting policies to succeed in this new reporting environment.

Through the year, the Department's main Corporate Accounts Receivable System (CARS) recognizes non-renewable resource revenues on the receipt of cash. To prepare financial statements at the year-end, staff estimate accruals to recognize those revenues earned but not received before the year-end. At the 1994-95 year-end, the allocation of cash received during the year was delayed for some CARS revenue accounts. Those preparing the accrual estimates did not adjust their estimates accordingly. As a result, year-end revenue totals were misstated.

The Department's CARS system is operated by the Financial Services Division. Other operational divisions maintain automated systems to control the Department's revenue activities. Communication at the year-end between the Financial Services and operational divisions is limited. As a result, financial statement items such as liabilities and disclosed commitments were initially miscalculated because those preparing the figures did not fully understand the Department's financial reporting requirements.

The Department also needs to address issues related to full accrual accounting. Mineral Tax continues to be recorded on the calendar year basis rather than on the accrual basis. The Department's financial records should have recorded unearned Rentals and Fees revenues totalling $50 million at the 1994-95 year-end.

Other entities

Financial audits of the following were also completed:

540540 Alberta Ltd. - year ended March 31, 1995
(Provided funding for operating shortfalls incurred by the Lloydminster Bi-provincial Upgrader Project)
Alberta Electric Energy Marketing Agency
- year ended March 31, 1995

Alberta Oil Sands Technology and Research Authority
- year ended March 31, 1995

Alberta Petroleum Marketing Commission
- year ended December 31, 1994

Energy Resources Conservation Board
- year ended March 31, 1995

Province of Alberta Investment in Syncrude Project
- year ended March 31, 1995

Public Utilities Board - year ended March 31, 1995
Take-Or-Pay Costs Sharing Fund
- eleven months ended November 30, 1994

Department of Environmental Protection
year ended March 31, 1995

Guidance to reader

The Department is to be commended for making efforts to develop meaningful performance measurement indicators for its forestry program, especially given the difficulties inherent in identifying measures for such a complex program. The measures developed so far are a sound basis for improving performance measurement in this area.

Scope of audit work

In addition to the annual financial audit, the following work was completed:

- An examination of a cost-sharing claim to the Government of Canada for Allowable Program Costs under the Waterfowl Crop Damage Prevention Program for the year ended March 31, 1995.

- A review of the systems used by the Department's Timber Management Division to generate performance measures and other accountability information, and to encourage sustained yield in Alberta's forests.

Forestry performance

The Department has developed a "Resource Sustainability Index" to measure and report on the health of Alberta's forests. The Index is published as a graph which shows the volume of timber harvested in Alberta's forests as a percentage of the volume of annual net growth. The graph also compares Alberta's results with those of British Columbia and Canada. The Index shows that, in percentage terms, from 1974 to 1993 growth in Alberta's forests exceeded the volume of timber lost due to harvesting, fires, insects, disease and land deletions.

This is a useful performance indicator because the information it conveys is compact and considerably more meaningful than previously published accountability information. I believe, however, that it can be further improved.

Displaying performance information as percentages is valid, providing that the reader understands the base upon which the percentages are calculated. The base used in calculating the Resource Sustainability Index is the forest that exists in the reporting year. However, if the size of Alberta's forests was drastically reduced as a result of reclassification of land for agricultural or industrial use, the resource sustainability index would not indicate that a problem existed, providing that the remaining forest was healthy, and being sustained. This is because the regeneration rate of only the remaining forest is being measured.

From time to time, public concerns are voiced about the health and size of Alberta's forests. The Department would be able to allay these concerns if its performance reports which presently show that Alberta's forests are being sustained, could also show that the forests are not diminishing in overall size.

The Department has agreed to look at ways to provide additional information.

Costs of services

It is recommended that the Department of Environmental Protection identify the main forestry related services that it provides, and measure and report the costs involved in providing those services.

Among other things, sustaining forests involves maintaining inventory systems, developing growth and yield tables to predict future growth, and growing new trees to replace harvested and burned trees. Managing the forests in 1995-96, excluding fire protection, will cost the Province approximately $60 million.

Performance information is of limited value if it does not include costs on outputs. Much of the currently reported cost information on the Timber Management Division's activities, however, relates to its inputs such as salaries, supplies and capital expenditures.

The first step, therefore, should be to identify the Division's main, or major, outputs or services. One such output might be hectares of forest successfully reforested. Meaningful accountability information could then be the number of hectares reforested each year, together with costs per hectare.

It is acknowledged that reforestation involves a number of different activities. For example, different treatments are required to grow different types of trees. The costs and results of each of these activities is essential to cost control and to planning future harvesting and reforestation strategies. In other words, the cost of the various reforestation and other internal services is valuable management information. When summarized, it can also supply meaningful accountability information about the services and costs of services provided.

Recent legislative changes have resulted in reforestation costs being funded by three different funds, namely, the General Revenue Fund, the Environmental Protection Revolving Fund and the Environmental Protection and Enhancement Fund. This scattering of funding complicates the costing of services. It also obscures the total and net cost of the Province's reforestation activities.

Environmental liabilities

In the 1993-94 Auditor General's Report (page 57), it was recommended that a policy be developed to address the identification and recording of the Province's environmental liabilities.

In response to this recommendation, a task force on environmental liabilities was formed. The task force was headed by the Department of Environmental Protection and included representatives from several other government departments, including the Treasury Department. The task force concluded that the Office of the Controller should formulate a government-wide accounting policy for recording environmental liabilities.

The task force also recommended that the Office of the Controller should bring to the attention of Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants the need for guidance with respect to the disclosure of environmental liabilities in the financial statements of governments.

I concur with the recommendations of the task force, and will continue to monitor the government's progress in identifying and recording environmental liabilities.

Lease revenue

It is recommended that at fiscal year-ends, the Department of Environmental Protection provide the Treasury Department with the information needed to enable lease revenue to be accounted for in the Province's Public Accounts in accordance with generally accepted accounting principles.

Lands and grazing revenue is generated from many types of leases with various terms, anniversaries and payment-due dates. The Province receives approximately $28.5 million each year under these leases and accounts for it on a cash basis. That is, the money is recorded in the Public Accounts in the year in which it is collected. This accounting practice does not comply with generally accepted accounting principles.

Generally accepted accounting principles require lease revenues to be reported in the years in which the revenue is earned. The Department estimates that approximately $14.3 million, which was received and treated as lease revenue in 1994-95, related to periods subsequent to March 31, 1995. This amount, therefore, should have been deferred and accounted for as unearned revenue.

Legislative non-compliance

It is recommended that the Department of Environmental Protection ensure that the financial implications of legislative and policy changes are considered before implementation.

During the past two years, the Department has not managed the financial implications of legislative and policy changes. This has resulted in unnecessary expenses and administrative difficulties for the Department.

As reported in the 1993-94 annual report (page 61), the Timber Management Regulation was amended to substantially increase timber dues effective January 13, 1994. The regulation, however, allowed forestry companies to pay dues at the old rate on sales of timber in their yards at January 12, 1994, provided that they submitted audited yard inventories to the Department by March 1, 1994.

The Department notified timber companies of the rate change but did not mention that the old rates would only apply if audited yard inventories were filed with the Department by March 1, 1994.

Ultimately, because the Department had failed to provide proper notification, it decided not to enforce the requirement for audited inventories. Forestry companies were allowed to pay dues at the old rate, even though they had not submitted audited inventories by March 1, 1994.

The Department has since received legal advice that the regulation cannot be amended to legitimize non-compliance with the regulatory amendment, and that a remission order is needed.

Another change concerned implementation of the Department's marginal timber policy. Section 78(2)(b) (now section 77(c)) of the Timber Management Regulation empowered the Minister to reduce timber dues where "the costs of cutting and manufacturing that timber will be exceptionally expensive." The Assistant Deputy Minister, Land and Forest Service established the marginal timber policy on May 30, 1994. However, the Department applied the policy retroactively to January 13, 1994.

As a result, some forestry companies were charged dues at the old, higher rate between January 13 and May 30, 1994. Since the charges exceeded the amounts required under the policy, the timber companies are entitled to credits or repayments or, where they have not yet paid, to have charges reduced. The Department should also consider obtaining remission orders under section 26 of the Financial Administration Act for timber dues owing between January 13 and May 30, 1994 that were forgiven under the marginal

timber policy. At present, no remission orders have been obtained and the Department is still attempting to estimate the amounts overpaid.

Environmental Protection Revolving Fund
year ended March 31, 1995

Financial reporting deficiencies

It is recommended that the Department of Environmental Protection eliminate the numerous accounting inaccuracies and delays which resulted in the Environmental Protection Revolving Fund not meeting the financial reporting deadlines set by the Treasury Department.

During 1994-95, the Environmental Protection Revolving Fund expanded from one operating component to nine. The Department, however, was not fully prepared for the accounting issues associated with the expansion. Failure to address some of these issues caused significant delays in finalizing the Fund's 1994-95 financial statements. Draft financial statements were not available for audit until the last week in June, 1995. This was four weeks after the date by which I had agreed to provide audit adjustments to the Treasury Department, and nearly two months after the date that draft figures were required for consolidation purposes. Even then, the draft statements were incomplete, contained numerous inaccuracies, and had not been reviewed by senior financial management.

Delays were caused by the Department's accounting staff failing to deal with accounting issues before they became problems. As a result, accounting records and systems were not in place to generate the needed information promptly or efficiently. There was a general lack of understanding of the disclosure requirements of generally accepted accounting principles.

I acknowledge that the Fund is likely to be smaller in 1995-96, but some accounting issues remain to be resolved. There are several areas where Departmental management need to address accounting and internal control weaknesses identified during the audit. In particular, there should be a plan to ensure that the Fund's 1995-96 statements are prepared and submitted to the Treasury Department on time.

Reforestation levies and costs

It is recommended that the Department of Environmental Protection establish accounting systems to enable reforestation levy revenue and expense to be recognized appropriately in the Environmental Protection Revolving Fund's annual financial statements.

The Province's annual reforestation levy revenue is about $6 million. Since the Revolving Fund is required by legislation to provide services at cost, reforestation costs should on average be of a similar amount.

Forestry companies that elect not to do their own reforestation pay a reforestation levy to the Province, at the rate of $6 per cubic meter of timber harvested. This rate is based on an estimate of Province-wide reforestation costs per hectare. Completion of reforestation work, however, can take up to fourteen years following the timber harvest. For financial reporting purposes, therefore, the Environmental Protection Revolving Fund's reforestation levies are deferred, and are not treated as revenue until the years in which the related reforestation costs are incurred.

This accounting treatment works well, providing that the $6 per cubic meter is an accurate estimate of reforestation costs. At present, however, the Department cannot demonstrate that the $6 levy is sufficient to recover these costs. If reforestation costs exceed the levy, the Fund should annually be estimating and recording in its financial statements the future losses that it has committed to fund.

There is a further difficulty in matching levy revenues with the related reforestation costs. The Department records levy revenues by permit number, whereas reforestation costs are recorded by cutblock or forest area. Permits, however, do not correlate exactly to cutblocks or forest areas. This makes it difficult to match the levies collected to the related reforestation costs. An added complication is that levies are due when timber is sold, but responsibility for reforestation begins when the sawlog timber is harvested, which can be several months earlier.

Another financial reporting problem stems from the way that responsibility for the cost of reforestation work was transferred to the Fund. Before April 1, 1994, levies were paid into the Province's General Revenue Fund, and treated as revenue when they were received. Reforestation costs were then paid from the General Revenue Fund and treated as expenditures when they were incurred. From April 1, 1994 onwards, however, levies are paid into the Environmental Protection Revolving Fund and accounted for as explained above. The problem arises because the Fund is now responsible for certain reforestation costs that should be funded by

levies that were paid into the General Revenue Fund in previous years.

Either the General Revenue Fund or another fund reimburses the Revolving Fund for the cost of reforestation work done on old cutblocks, meaning cutblocks on which levies were paid prior to April 1, 1994. Accordingly, the Department must differentiate between reforestation costs incurred on old cutblocks and on new cutblocks. The Department is having difficulty doing this, partly because it has defined old cutblocks as those that were harvested prior to May 1, 1994, regardless of which fund received the levy. Accordingly, there is a risk that reforestation costs are being charged to the wrong fund.

Tire Recycling Management Board
year ended March 31, 1995

In addition to the annual financial statement audit, my staff completed an examination of the systems used by the Tire Recycling Management Board (the Board) to monitor the Province's stockpiles of tires.

Method of collecting Advance Tire Disposal surcharges

It is recommended that the Tire Recycling Management Board provide the Minister of Environmental Protection with an assessment of whether the current method of collecting tire surcharges is cost-effective, and whether it is having the desired impact on tire consumers.

In the last two Auditor General's reports (1992-93 page 100; 1993-94 page 64), the Auditor General recommended that the Tire Recycling Management Board consider alternative ways of collecting surcharge revenue. Although last year's recommendation was formally accepted by the government, the Board has yet to address this concern.

At the conclusion of this year's audit the Board indicated that it will bring this issue forward to the Minister and ask for his guidance.

Stockpiled tires

Recommendation No. 20

It is recommended that the Tire Recycling Management Board establish a reliable methodology for measuring the stockpile of used tires in Alberta to determine whether the objective of reducing the stockpile is being achieved. The Board should also revise its strategy for reducing stockpiled tires by taking into account environmental risk factors such as potential fire hazards.

The Tire Recycling Management Board's business plan for 1995 to 1998 states that one of its general goals is to "have capacity in place which could utilize 100 per cent of the volume of scrap tires discarded annually, plus a minimum of 10 per cent annually from stockpiles."

To measure whether the Board is meeting its goal, it needs more current and more accurate information about the number of used tires stockpiled in Alberta. A 1993 survey indicated that the number then was approximately six million; a more recent estimate put the number as high as seven million. Without a more reliable methodology for measuring the stockpile of used tires, the Board is unable to report on its success in achieving its objectives.

The Board maintains a scrap tire recycling program which is funded by a surcharge of $4 imposed on all new tires sold in the Province. The surcharge was originally set based on the experiences of Ontario and British Columbia. The Board needs to determine whether the income being generated will be sufficient to meet its obligations of disposing of 100 per cent of the volume of scrap tires discarded annually, plus a minimum of 10 per cent annually from stockpiles. I understand that the Board has recently initiated a new stockpile survey to obtain more accurate estimates of the tires presently in stockpiles. This information will enable an assessment of whether the $4 surcharge will be sufficient to deal with the problem of stockpiled used tires.

The Board should also assess which stockpiles are in most urgent need of disposal because of potential fire or other environmental hazards. Once this is known, a strategy can be developed to give priority to the early elimination of these stockpiles. I understand that the Board has recently created a model to assess the environmental hazards associated with stockpiles, and has begun removing tires from one landfill due to a potential fire hazard.

Other entities

Financial audits of the following were also completed for the year ended March 31, 1995:

Alberta Environmental Research Trust
Environment Council of Alberta
Natural Resources Conservation Board
Alberta Special Waste Management Corporation

Department of Family and Social Services
year ended March 31, 1995

Guidance to reader

The Department of Family and Social Services is undergoing significant change. It is taking steps to reduce the Supports for Independence caseload and for monitoring payments to individuals. Further, the Department is implementing recommendations made by the Commissioner for Services to Children that will result in a significantly different Departmental structure.

My recommendations relate mainly to the need to measure and report cost and effect in the Supports for Independence program, and in the area of Community-based Individual Services.

The recommendations also describe opportunities for the Department to improve its controls, and to reduce its operating costs. In previous years, my staff examined one of the sub-systems of the Department's largest program: Supports for Independence-transitional support. This year, my staff again looked at some of the sub-systems and examined controls over Personal Support payments, and recovering funds from the parents of supported children. I make recommendations for improvement in both of these areas.

I had hoped that simplification of policy and the reduction in caseload would reduce the number of errors occurring in the Supports for Independence Program. But as noted in more detail below, the number of policy compliance problems is increasing and overpayments could be occurring as a result.

The Department has introduced a new monitoring system, called "Error Detection, Correction and Improvement". The Department believes that this system will identify instances where matters of client eligibility and entitlement have not been addressed. I look forward to reviewing this system in operation, and hope to be able to report a reduction in error rates in future years.

Scope of audit work

In addition to the annual financial audit, the following work was completed:

- An examination of the systems that generate cost and other information used to account to senior management, and to the Legislative Assembly, for the services provided by the Supports for Independence program.

- A further examination of benefit payments under the Supports for Independence and Assured Income for the Severely Handicapped Programs. This examination included reviewing the procedures used for promoting compliance with the Department's program manuals, and the progress made in addressing recommendations made in this area in previous years.

- An examination of payments for personal support services under the Supports for Independence Program, and related administration systems.

- An examination of the systems used to initiate recoveries of funds from the parents of children who are supported under the Supports for Independence Program.

- An examination of the systems used by the Department to monitor and report on services provided by contracted agencies to persons with disabilities.

- Audits of the 1993-94 cost-sharing claims under the Vocational Rehabilitation of Disabled Persons Agreement and the Canada Assistance Plan Agreement with the Government of Canada, and an examination of the systems used to generate these claims.

Supports for Independence - Results of Program

Recommendation No. 21

It is recommended that the Department of Family and Social Services determine the impact and cost of the various initiatives it has implemented to reduce the Supports for Independence caseload.

The Supports for Independence caseload has reduced from 96,300 in January 1993, to 51,500 in May 1995. A decrease of 46%. The reduction is due, in large part, to welfare reforms introduced in March 1993 and other ongoing initiatives. However, no clear link has been established between caseload reductions, and the various reforms and initiatives introduced. Furthermore, by not costing outputs, there is no way of determining the cost of, or the savings achieved by, each initiative. This information is important to determining the ongoing cost-effectiveness of each reform and initiative, its continuing impact on caseloads, and for future planning purposes.

To measure the impact of initiatives, the Department needs to gather information on why clients leave or return to the Supports for Independence program. For example, the Department should know how many, or what percentage of, clients leave the program because they find employment due to the training they have received. If

they later return, the Department should know how long they were employed, and why they have returned. Information of this nature would enable the Department to assess the effectiveness of the Province's training initiatives, and evaluate their cost-benefits. The same concept applies to all reforms and initiatives affecting the Program.

It is acknowledged that clients leaving the program cannot be required to provide information about why they are leaving, and some may simply disappear. If a representative number provided the information, however, the Department would have a basis for assessing which initiatives are worth retaining, and which are not, and which are the most and least cost-effective.

My Office first raised this concern following an audit several years ago, and was informed that the Department had decided not to implement the recommendation because gathering the data could violate the rights of clients. However, I am suggesting that clients leaving the program be asked, not required, to provide the information.

Supports for Independence Program - costing services

It is recommended that the Department of Family and Social Services improve its reporting to the Legislative Assembly of the cost and impact of the Supports for Independence Program.

The Province's Public Accounts show annual Supports for Independence program expenditures at just over $600 million. In its annual reports, the Department describes some of the services it provides, but not the full cost of providing them.

I believe that clear and concise information is needed that:

- identifies the main services or outputs of the Supports for Independence program,

- determines the full cost of producing each service or group of services, and

- assesses the impact the services are having on the program's legislatively approved objectives.

Identifying the main services or outputs

With a large and complex program like Supports for Independence, it is important to identify the significant outputs or groups of services. The Department needs to improve the description of its outputs.

For example, clients who are not working, but who are expected to work, are categorized as "Employment and Training Support" clients. The program's objective for these clients is to support them and help them find work. The program assists the clients by preparing them for the job market either through training, or work experience. These services are outputs. The Government Estimates for 1995-96 include estimates for "Employment and Training Support" and "Employment Initiatives". However, it is not clear what services are provided in each category.

Determining full costs

Continuing with the above example, the costs currently collected under the "Employment and Training Support" category are incomplete. The Government Estimates, and the Public Accounts identify only the costs of the direct benefits paid to clients under the heading of "Employment and Training Support". This category, however, does not include unallocated costs such as caseworker costs, head office costs, regional and district management costs, and administrative or accommodation costs that I estimate to amount to $90-100 million. Therefore, Members of the Legislative Assembly cannot determine how much the Province is spending on these services, or for that matter, what services are being provided, and with what effect.

Allocating indirect and overhead costs to services or outputs need not entail developing complicated and costly accounting systems.

Assessing the impact that the services or outputs have on the program's objectives

The Supports for Independence program's objectives are to help clients achieve independence and self sufficiency. Accountability reporting should include information which links the cost of the outputs, or services provided, to the impact those services have, such as the numbers of clients who find work, or other means of financial independence. A similar accountability approach should be used for all Supports for Independence client categories.

Information of this nature would enable a better understanding of the program's performance, and make it possible for the Department

to report on the transformation of inputs (direct, indirect and overhead costs) into outputs (client services delivered), and the effects of those outputs on the program's objectives (ie, the number of clients achieving independence). My staff will be working with departmental staff to make progress on this very difficult issue.

Supports for Independence - transitional support costs

In the 1993-94 annual report (page 68), the Auditor General recommended that the Department review the eligibility of Supports for Independence clients who were classified as in need of transitional support. There was evidence to suggest that significant savings could be achieved by identifying clients who should not be in this category.

The Department responded by reviewing the appropriateness of all clients who were classified as in need of transitional support. This resulted in approximately 8,000 files being transferred to more appropriate categories. Of these, over 5,000 clients were moved into the employment and training category, and are now receiving appropriate training, or are no longer supported by the program.

Controls over program payments

Recommendation No. 22

It is recommended that the Department of Family and Social Services extend the present testing of client files that contain irregularities, to determine the monetary impact of the deficiencies found.

The cost of benefits provided under the Supports for Independence and Assured Income for the Severely Handicapped programs during the year ended March 31, 1995 totalled almost $770 million.

Each year, my staff examine a sample of benefit payments, and the evidence available to demonstrate that the recipients (clients) were eligible for the assistance received. A long-standing concern arising from this work is the large number of client files that lack proper documentary evidence to support the calculation of benefits provided. An additional concern is the lack of completion of key planning documents the Department uses to assist the clients' progress to independence. Of the files examined during 1994-95, 35% had deficiencies of this nature, compared to 22% of the files examined during 1993-94. The Department's own testing of client files during 1994-95 revealed similar results.

A 35% error rate demands attention and the Department has indicated that it will use the new Error Detection, Correction and Improvement function to identify concerns. However, I feel that additional work will be necessary. I believe that many of the irregularities found could be followed up and evaluated by

contacting the client or the social worker involved so that the errors can be quantified. Fully evaluating these irregularities will help the Department determine the extent of monetary loss occurring as a result of the deficiencies and help focus the Department on areas that require improvement. Unless there is proper evidence that a client's identity, dependants, living arrangements, medical condition, assets, income, employment potential etc., have been verified, the Department cannot demonstrate that only appropriate benefits are being paid.

Personal Support Services

It is recommended that the Department of Family and Social Services improve the monitoring of payments of personal support benefits.

Some Supports for Independence program clients are categorized as being in need of support because of the severity of their handicaps. Although these clients represented only 3.8% of the Supports for Independence caseload at March 1995, their benefits during 1994-95 totalled nearly $60 million, or 11% of the program's expenditures.

The current benefit ceiling for Personal Support Services is $3,000 per month per client, plus up to a maximum of $360 (12% of $3,000) for administrative costs incurred by the provider of the services. Some clients whose benefits were approved prior to January 1991 receive more than this amount under "grandfathering" arrangements.

Given the high cost of the support provided to these clients, it was expected that the Departmental staff would monitor, through the clients' guardians, trustees and service providers, the quality and costs of the services supplied. However, upon examination my staff found that timely assurances are not being obtained by the Department to support that all amounts paid to trustees are subsequently spent on services to clients. This could mean that the Department is making payments in excess of the amounts required.

Even when assurances are being obtained, the methods used are often inconsistent. Some files are reconciled by comparing the budgeted costs in the individual service plan to benefit payments made by the Department; others compare actual costs incurred by the service providers with the benefit payments made by the Department. The latter method is undoubtedly the better and, if done in a timely fashion, can minimize the risk of benefit overpayments that may otherwise remain undetected or outstanding for extended periods.

Recoveries from parents of supported children

It is recommended that the Department of Family and Social Services develop procedures for identifying changes in the circumstances of clients' families so that prompt action can be taken to effect recoveries of benefit payments through recovering funds from parents of supported children.

Where the Department provides support for a parent and his or her children, it is allowed to pursue the second parent for maintenance payments. In this way, the Department recovered $6.6 million through voluntary maintenance agreements. A further $11.9 million was recovered through court orders under the Maintenance Enforcement Program of the Department of Justice.

Generally, the Department's procedures for recovering support payments when clients first apply for benefits work well. However, the circumstances of clients' families can change. For example, the second parent can obtain employment or can otherwise become capable of paying maintenance to support the children. Such changes can provide new opportunities for recovering funds from parents of supported children, but my staff found that where changes had taken place, recovery opportunities were not always pursued. A review conducted by the Department a year ago in Edmonton reached similar conclusions. It was estimated that as many as 700 files should be reviewed because client family circumstances had changed. Of the 400 files assessed to date, 115 files are being reopened to pursue the other parent for maintenance, or to increase the amount of maintenance being paid. Despite these savings, procedures have not been established to detect changes in family circumstances on an ongoing basis.

Recoveries of past maintenance and/or reductions of benefit payments will likely take time as many cases are still before or waiting to go before the courts. However, recoveries effected, to date, vary from $1,368 to $2,604 annually per client. This suggests that significant cost savings can be realized by the prompt identification of changes in parents' circumstances, thereby enabling referrals for recoveries to be initiated promptly.

Contracted Agencies - Costing of services

It is recommended that the Department of Family and Social Services determine and analyze the per-client costs of services provided to persons with disabilities.

During 1995-96, the Department will spend approximately $74 million on Community Based Individual Services for persons with disabilities. These services are contracted for directly by the Department with service providers.

At present, the Department does not know the costs of the various services provided, or per-client costs. This limits the Department's ability to manage its costs and services, and to produce meaningful performance reports.

Service cost and per-client cost information could be used in a variety of ways to identify and promote more cost-effective management practices. For example, it would be possible to compare the cost of providing similar or alternate services to individual clients or groups of clients based on the type of services required and the location of the clients. It would also be possible to identify service and cost trends, and to compare costs with prior periods, between regions, between contracting agencies, and perhaps with other jurisdictions.

Cost information of this nature could also be used to meet the government's performance reporting requirements. The Department would be able to report to the Legislature on the nature and cost of the various services it provides to persons with disabilities. This information could then be linked to an assessment of the impact of those services.

I am informed that the Department is currently pursuing several initiatives, including the development of a system for tracking direct costs and various other information about services provided to persons with disabilities.

Vocational Rehabilitation of Disabled Persons - Claim

It is recommended that the Department of Family and Social Services liaise with the Alberta Alcohol and Drug Abuse Commission to improve the accuracy of information used to prepare cost-sharing claims under the Vocational Rehabilitation of Disabled Persons Agreement.

The Department of Family and Social Services consolidates annual claims for cost-sharing under the Vocational Rehabilitation of Disabled Persons Agreement with the Government of Canada. Approximately $23 million was claimed for the year ended March 31, 1994. Several Alberta government departments and agencies submit claims under the Agreement, and the Department compiles the annual composite claims that are audited by my Office.

The March 1994 claim submitted for audit contained significant errors, many of them caused by logic errors in the computer spreadsheets used to summarize the cost information. The most significant error found by my staff, totalling more than $650,000, was caused by mistakes in spreadsheets created by the Alberta Alcohol and Drug Abuse Commission. Similar errors in the claim

two years ago were also caused by logic errors in spreadsheets used by the Alberta Alcohol and Drug Abuse Commission.

Long-term costs of children in care

In the 1993-94 annual report (page 69), the Auditor General reported that the Department should take into account the cost of acceptable alternatives when deciding on the most appropriate method of supporting children in need of protection. The Auditor General was concerned that the cost of the government taking full responsibility for a child was significantly higher than the cost of supporting the child within its family, and yet costs did not seem to be considered when acceptable alternative solutions were available.

The Department is in the process of changing the organizational structure for delivering child welfare. It is my understanding that the costs of delivering services, between acceptable alternatives, will always be considered in future.

Department of Federal and Intergovernmental Affairs
year ended March 31, 1995

There were no matters reported to management at the end of this year's annual financial audit.

Department of Health
year ended March 31, 1995

Guidance to reader

1994-95 was a year of transition for health care. The newly established regional health authorities assumed responsibility for the delivery of health services. Health facilities underwent major change to reduce duplication and overlapping activities. The new authorities were required to develop a governance system and to present three-year business plans. New planning and administrative systems are also being developed and implemented by management.

This year, our audit work continued to focus on systems to improve the effectiveness of funds provided for health care. Much of the current attention in health administration is focused on the allocation of funds and the level of funding for health care. However, I believe that better information systems are needed to help determine whether the resources provided are used effectively. I do recognize that in the current period of transition it was not possible for management to focus fully on this important issue.

The recommendations which follow are in the main designed to enhance systems used to determine where cost-effectiveness can be improved.

Scope of audit work

In addition to the annual financial audit, the following work was completed:

- An examination of the systems used to fund physicians.
- An examination of the systems used to report on the use of public funds for health care.
- An examination of the implementation of the system used to pay physicians.
- An examination of the systems used to administer the Alberta Seniors Benefit Program.
- Follow up of matters previously reported.

Funding systems

Recommendation No. 23

It is recommended that the Department of Health foster funding systems that focus on enhancing the health of the population.

Health services can be broadly categorized into components consisting of services designed for the prevention and treatment of illness, and palliative care. An effective health system should provide for an appropriate level of funding for each of these components. For example, an effective health system would balance the cost of preventive services against the cost of treatment, to take

advantage of any savings which could be realized through the prevention of illness.

It is our view that medical services and the related payments should be linked to the achievement of health goals. If the overall health goal is to maintain or enhance public health, then funding strategies should provide the necessary incentives. The present system, however, is based on physician/patient contact, and pays physicians on the basis of each service provided. Some believe that the current fee for service payment system encourages the provision of services. The fee for service payment system appears to contain no obvious strategy to promote more cost-effective services, or discourage unnecessary services. The system provides financial incentives based on visits rather than on improving the health status of Albertans. For the funding system to help promote the goal of enhancing the health of the population, funding should be targeted towards those services that are effective.

An effective funding system would likely contain several compensation systems. For example, medical services which need to be promoted may be more effectively funded based on fee for service. It is recognized that there is a capitation on the total amount paid to physicians, but payments to individual physicians are based on the number of services provided.

Some needed services which are not in demand may require promotion. For example, services related to the prevention of illness are generally not demanded by those who can benefit from such services. On the other hand, there is high demand for palliative care for those who can benefit. To be cost-effective, different funding systems are required in the preventive, treatment and palliative care components of health care.

I intend to continue to examine Alberta's health funding systems from the perspective of determining whether they are helping to achieve health goals. My examination criteria will continue to focus on factors related to measuring and reporting the cost and effect of health services provided.

Administration of health programs by Regional Health Authorities

Regional health authorities are responsible for meeting the health needs of their communities. The regions are expected to manage their resources effectively, and to provide services within the resources available to them. However, health authorities are responsible for only a part of the resources used to deliver health services within their regions. The cost of physician services, amounting to $849 million in 1994-95, is not reflected in regional costs. Since physicians largely determine the kind and the number of services to be provided to patients, they, through their individual

actions, effectively set treatment priorities. It is acknowledged that health facilities management and hospital utilization committees also influence the provision of health services as delivered within the institutional setting.

If regional health authorities are to be held accountable for the cost and effects of health services within their regions, they should be able to assess whether the effects of physician services, together with the related costs, are meeting the health needs of their communities. I acknowledge that there are other costs, such as drug costs, that are not reflected in regional costs.

In my view, the Department of Health, with the collaboration of regional health authorities, needs to consider how each authority can be responsible for the cost and effect of all health services provided within its region.

Assessment of regional health authority governance

Recommendation No. 24

It is recommended that the Department of Health, with the participation of the regional health authorities, review the progress made by the authorities in establishing effective governance with a view to promoting best practice.

Almost all of the 124 acute-care facilities and 137 long-term care facilities, which previously operated as separate organizations, have been merged into 17 regional health authorities and two Provincial health boards. Funds provided to health authorities exceed $2.1 billion annually.

Health restructuring has provided the management of health authorities with extraordinary challenges that must be tackled. The environment of complex service delivery and restructuring tests even the very best managers.

The Health Plan Coordination Committee, which was established by the Minister, together with the Department of Health, provided an orientation for health authority members when they were appointed in June 1994, to help members with issues of governance. Expectations were set on general governance models. I believe that the Department, with the cooperation of the authorities, should now assess whether governance of the authorities is operating effectively in practice.

The review should include an assessment of whether authorities have been successful in developing a governance system to promote organizational objectives. The assessment of the governance system would focus on:

- whether the authorities and health boards are able to develop appropriate performance targets for the region and link these targets to the activities and budgets proposed by management;

- whether reliable and relevant information is provided by the region's systems to report on the performance of management in relation to the targets;

- whether progress towards improving the health status of its population is according to plan;

- whether the comparison with the results and costs of other regional health authorities has been evaluated; and

- whether the authorities and health boards evaluate their own performance.

Health services provided by community, voluntary and private organizations

Recommendation No. 25

It is recommended that the Department of Health and the regional health authorities establish a system to optimize the use of significant public funds by community, voluntary and private organizations in delivering regional health services.

At the time that regional health authorities (RHAs) were established, many regional health organizations were merged into the regional board-governed entity. However, some community, private and voluntary organizations providing publicly funded health services were not merged into the RHAs. These organizations are funded by the RHAs.

Community, private and voluntary organizations which deliver health services often blend special organizational objectives with the delivery of health services. Consequently, it is important that when such organizations depend on public funds for the delivery of health services, that public funds are targeted towards authorized health services.

The use of such organizations does not remove the RHAs' responsibility for delivering cost-effective health care within the region and for providing an accounting of services and results received from public funds. For the RHAs to meet their responsibility, they need to set performance expectations which

include standards for service quality and cost benchmarks. Furthermore, reporting standards need to be established in order that information on the cost and results of health services, by region, is available regardless of who delivered the service. I believe that these standards should be incorporated in the contractual arrangements entered into between the RHAs and the organization.

While the standards for funding provided to private facilities, who operate mainly the long-term care facilities, can be more easily accomplished, there will be considerable challenges in developing standards for voluntary and community organizations who operate significant health care facilities.

Other issues that need to be considered are:

- how should the different objectives of the operator and the RHA be reconciled when operators are asked to deliver health programs which may conflict with RHA objectives?

- how will information on the use of public funds in the region be reported to the Legislative Assembly if assets, liabilities, costs of outputs and other information such as salary disclosure for entities not merged into the RHAs are excluded?

- how will the RHAs ensure that there is equity in funding, particularly related to the significant facilities operating within a region, so that appropriate resources are transferred to meet the obligations of the operators of the entities?

- who should bear the excess costs resulting from extra administrative staff, systems and other overhead which could have been eliminated through a merger?

- whether reporting standards applicable to the public sector should be applied to unmerged organizations which depend on public funds.

Undoubtedly, the Department needs to be involved since certain significant organizations which were not merged are subject to agreements entered into by the Minister.

Foundations to support health facilities

It is recommended that the Department of Health and regional health authorities ensure that there is an effective reporting relationship between health facility foundations and regional health authorities.

Foundations are legal entities established to support the objectives of a related health facility. The legislative framework for foundations

is found in the Regional Health Authorities Foundation Regulation. It allows regional health authorities to establish new foundations, subject to the Minister's approval of the by-laws, and enables foundations which existed prior to regionalization to be continued. Existing foundations are to report directly to the Minister of Health.

In my opinion, there is a need for the Department, in collaboration with the regional health authorities, to define how the continuing foundations should be responsible to regional health authorities, and to their communities. The following matters need to be addressed:

- the need to include all significant costs incurred by regional health authorities on behalf of the foundations in measuring the results of the foundations' operations;

- the need for an adequate planning and budgeting process, including a periodic review of operating results;

- the requirement for coordination of fund raising activities within a region so as to maximize revenues, including the sharing of successful fund raising strategies with other foundations; and

- the need to determine priorities for the use of funds raised, and to resolve any conflicts between community and regional needs.

Funding special programs

It is recommended that the Department of Health improve its procedures in determining funding adjustments.

During 1994-95, the Department adjusted results of the Hospital Performance Index (HPI) to provide additional funding to a regional health authority for the tertiary rehabilitation program and the forensic psychiatry program operated at one hospital. The additional funding provided for the special program was $3.1 million.

A review of information supporting the additional funding indicated that:

- The Department used 1992-93 information to determine this special program funding adjustment. Had information for 1993-94 been used, which was available at the time the adjustment was finalized, reduced additional funds would have been provided.

- The use of incorrect workload rates increased the special funding by approximately $0.6 million.

Public reporting

In the 1993-94 annual report (page 78), it was recommended that the Department of Health establish procedures to report publicly on the cost of the services funded by the Province and delivered by the regional health authorities. Since that time, the Department has initiated the development of reporting policies by regional health authorities and the Provincial health boards. However, there is not yet a consolidated report that links the funds provided by the Province with the nature and cost of health services delivered by the health authorities. Members of the Legislative Assembly, management of RHAs and the public need such reporting to understand how the funds provided are being used. In my view, information is required on the cost and efficacy of the health services provided, and on the public's health status.

The Department is currently considering how it will report on a consolidated ministry basis.

My staff will review progress towards adequate public reporting in future audits.

Assets and liabilities

In the 1993-94 annual report (page 79), it was recommended that the Department of Health require that the assets and liabilities transferred to regional health authorities be recorded at appropriate values, and that any payments by regions to existing health boards for the net assets acquired take into account government grants previously provided for these assets. The Department's guidance to regional health authorities and Provincial health boards satisfactorily resolved our concerns.

Financial reporting by Regional Health Authorities and Provincial Health Boards

The Department of Health provided guidance to regional health authorities and Provincial health boards on the preparation of financial statements. I endorse the Department's position that health authorities' financial statements should be prepared in accordance with generally accepted accounting principles, and that the accounting policies adopted should be consistent among health authorities. The recommendations that follow are intended to help improve the quality of financial reporting. Useful financial reporting will meet the test of being understandable, relevant, reliable and comparable. I believe that these characteristics can be met if health care reporting communicates the cost and the related effects of publicly funded health services.

Method of accounting

Recommendation No. 26

It is recommended that the Department of Health advocate those accounting policies which best support performance measurement and reporting by regional health authorities and Provincial health boards.

There are two methods of accounting which are generally accepted for use in the not-for-profit sector. The restricted fund accounting method focuses on the receipt and consumption of resources provided for specific purposes (ie, restricted funds). The defer and match method focuses on providing a consolidated view of operations, and matches restricted use revenues with related expenses in the period of consumption. Although, both methods are acceptable under generally accepted accounting principles, the method chosen should be the one which best meets the objectives of the reporting entities.

I believe that the defer and match method is better suited to reporting the financial performance of RHAs since it clearly shows the extent to which external resources were sufficient to meet the annual cost of delivering health outputs. Reporting on performance requires matching revenues with costs, and allocating all costs to operations in the period of consumption. The defer and match basis achieves this. I believe that restricted fund accounting is more suitable for organizations where reporting on the use of restricted funds is a prime consideration. The Department has specified that health authorities should use the restricted fund accounting method.

The following example is provided to illustrate my view that restricted fund accounting is inappropriate in the case of RHAs.

Restricted fund accounting normally reports the consumption of funding of capital assets in a separate fund. Therefore, the cost of capital asset consumption is often not considered an operating cost even though these costs are a necessary component of operating activities. Further, external funds provided for capital assets are recognized as revenue when received, and amortization is reported when the capital asset is consumed. This mismatching of revenues and expenses can result in annual surpluses and deficits that are unrelated to operations.

Reporting guidelines

Recommendation No. 27

It is recommended that the Department of Health examine its guidance to regional health authorities to test whether it is helping them to meet the standards of reporting expected of those using public money. In particular, the Department should consider guidance on budget information and expense groupings.

Nature of guidance

I am directing my comments on the quality of reporting to the Department because I believe the Department is in the best position to provide guidance to all of the 17 regional health authorities and the two Provincial health boards. By applying appropriate reporting standards, the regional health authorities and Provincial health boards should be able to improve on the quality of reporting from that which was provided during 1994-95 by most of these authorities.

Budget information

The Department did not recommend to RHAs that their financial statements include the annual budget. Such information is a standard part of an accountability framework because it permits the comparison of planned and actual results in financial terms. It is for this reason that annual budgets are included in the financial statements of publicly funded organizations.

Reporting on outputs

The Department's proposed policy for reporting of health expenses by health authorities requires expenses to be classified using a mixture of input, activity, location and service delivery costs. I agree that health authority management needs detailed information on input and activity costs for cost control purposes. However, the evaluation of cost-effectiveness requires information on the cost of outputs, and how those outputs link to health outcomes.

My Office has previously recommended to the Department that health programs need to be defined in a manner that supports the measurement of performance. There is a need to change from reporting on resources used, to reporting on outputs and their related costs and effects. I realize that providing information on outputs and outcomes requires study and that it will be some time before meaningful information is available to help determine the effectiveness of health expenditures. However, in my view, it is crucial that the Department take a leading role in encouraging health

authorities to report the full cost of services by major category or program.

Provincial Mental Health Board
year ended March 31, 1995

Reporting entity

It is recommended that the Provincial Mental Health Board determine and report the revenues, expenditures, assets and liabilities relating to the Raymond Care Centre, Claresholm Care Centre and the community mental health clinics.

Financial information relating to the assets, liabilities and operational costs of the Raymond Care Centre, Claresholm Care Centre and the Community Mental Health Clinics, which were transferred to the Provincial Mental Health Board on April 1, 1995, has not been determined. This information is necessary for the Board to manage the assets and liabilities it assumed under health care restructuring and for which it is accountable. The Board will need to identify and report these amounts in its 1995-96 financial statements. To report costs relating to its operations, the Board will also need to identify all costs paid by other parties on its behalf.

Other entity

A financial audit of the **Alberta Alcoholism and Drug Abuse Commission** for the year ended March 31, 1995, was also completed.

REGIONAL HEALTH AUTHORITIES, HEALTH BOARDS, CONSOLIDATED ENTITIES AND THEIR FOUNDATIONS

Auditing

Regional health authorities, health boards and their foundations operate under the Regional Health Authorities Act (RHA Act), most of which was proclaimed in force on June 24, 1994. Consequently, Provincially owned hospital boards were wound up and regional health authorities assumed their assets and liabilities. The RHA Act requires that unless the Minister appoints the Auditor General to express an opinion on the financial statements of a region, the region must appoint an auditor.

Through the RHA Act and the Government Accountability Act, the Legislative Assembly has enacted accountability provisions for health boards and authorities. These accountability provisions are necessary because the authorities are funded by the Province. Furthermore, members of the Legislative Assembly have a responsibility to demand accountability for the use of the dollars that they have provided. As a part of the legislated accountability process, I am required to report to the Legislative Assembly in respect of the health boards and authorities.

Certain health authorities recognized my responsibility as a legislative auditor and have appointed me as the auditor of their regions in order to facilitate the legislated accountability process. I believe that this arrangement will expedite audit of the financial statements in an efficient way and also permit me to meet my reporting responsibility to the Legislature. Where I have been appointed the auditor of a health authority, I intend to appoint a private sector audit firm as my agent to perform the audit of the required financial statements. With respect to those authorities who have appointed their own auditor, I will need to perform such additional audit work as is necessary to meet my reporting responsibility.

Volume 4 of Public Accounts

The 1994-95 financial statements of the health boards and authorities are not included in the Province's consolidated financial statements, but are included in Volume 4 of the Public Accounts.

I congratulate the two health boards and the four regional health authorities that included audited consolidated financial statements. Audited consolidated financial statements helped these health boards and authorities gain a comprehensive understanding of their financial position and operations and also provided them with the required base for financial planning and control. Moreover, meaningful financial statements require the application of consistent accounting policies for all merged facilities in a region. This consistency was achieved through audited consolidated financial statements. Audit of

only the individual facilities and not the combined financial statements does not ensure that the summarized information is meaningful because it may not have been adjusted to a common basis of reporting within a region.

I believe that all health boards and authorities need understandable, relevant and complete information on their assets, liabilities, revenues and expenditure prepared on a consistent basis in order to administer their financial affairs. It is for this reason that, on page 134 of this report, I have recommended what I believe is an appropriate method of accounting for health boards and authorities. This method will assist in presenting the financial statements of health boards and authorities included in volume 4 of the Public Accounts in a way that is comprehensive and relevant.

Capital Health Authority
year ended March 31, 1995

In addition to the annual financial audit, audits of the financial statements for the year ended March 31, 1995, of the following entities which were merged into the Capital Health Authority were completed:

Children's Health Centre of Northern Alberta,
Glenrose Rehabilitation Hospital, and
University of Alberta Hospital Site

Cost of health services

In my 1993-94 annual report (page 86), it was recommended that the University Hospitals Board continue to improve the systems used to determine and report the cost of health services by accumulating patient costs by treatment rather than by the patient's most significant condition.

Due to restructuring within the health care delivery system during 1994-95, the University Hospitals Board was disestablished and the operations of the University of Alberta Hospital were amalgamated into the Capital Health Authority.

In future audits at the Capital Health Authority, my staff will review the progress towards linking health services costs to treatments.

Calgary Regional Health Authority
year ended March 31, 1995

In addition to the annual financial audit of the Calgary Regional Health Authority, audits of the following entities which were merged into the Authority were completed for the year ended March 31, 1995:

Alberta Children's Hospital, and
Foothills Hospital

Provincial Mental Health Board
year ended March 31, 1995

In addition to the annual financial audit of the Provincial Mental Health Board, audits of the following entities which were merged into the Provincial Mental Board were completed for the year ended March 31, 1995:

Alberta Hospital Edmonton, and
Alberta Hospital Ponoka

Children's Health Foundation of Northern Alberta
year ended March 31, 1995

Accounting and administrative controls

It is recommended that the Children's Health Foundation of Northern Alberta improve its accounting and administrative controls.

Improvements in accounting and administrative controls would help the Foundation budget and monitor its expenditures and safeguard its cash, as illustrated by the following audit findings:

- Delays of up to one month occurred in depositing cash, and cash was not adequately safeguarded prior to deposit. Subsequent to the year end, there was a theft of cash resulting in a loss of $2,000.

- The duties of receiving and accounting for cash were not adequately segregated.

- Journal entries and monthly bank reconciliations were not approved after preparation.

- The Foundation requires project reports to be submitted by grant recipients upon completion of funded projects. Follow-up procedures were lax and, as a result, several completion reports for projects funded in 1992-93 and 1993-94 have not been received by the Foundation.

- Restricted fund contributions were recorded as unrestricted fund contributions.

- Some significant expenditures and related liabilities were not recorded.

- Software purchases made during the year were not capitalized and a basis for amortization was not developed.

- The Foundation did not budget for all proposed expenditures. For example, equipment grants of $600,000 and paediatric education grants of $67,000 had been omitted from budgeted expenditures.

The financial statements of the Foundation were corrected prior to their issuance for all material accounting errors identified by the audit.

Other entities

Financial audits of the following were completed for the year ended March 31, 1995:

Alberta Cancer Board
Alberta Hospital Edmonton Foundation
Foothills Hospital Foundation
Palliser Health Authority

My reports on the financial statements of the following contained reservations of opinion for the year ended March 31, 1995 because the Foundations receive donation revenue which is not susceptible of complete audit verification:

Alberta Cancer Foundation
Children's Health Foundation of Northern Alberta
University Hospitals Foundation

Department of Justice
year ended March 31, 1995

Guidance to reader

The Department of Justice has responsibility for collecting most fines imposed within the Province. This is a substantial responsibility as the Department collects more than a million fines each year, totalling approximately $65 million. About one third of this amount is revenue of the Province of Alberta; the rest is collected on behalf Alberta municipalities and the federal government. The 1994-95 audit of the Department of Justice focused mainly on the Department's responsibility for collecting all fines imposed within the Province.

Scope of audit work

In addition to the annual financial audit, my staff completed an examination of the system used by the Department to manage the collection and reporting of fines revenue.

Performance reporting

Recommendation No. 28

It is recommended that the Department of Justice determine the costs and results of its fines collection activities to provide this information to the Legislative Assembly, the Provincial Court of Alberta, and municipalities.

The Department does not have a system capable of generating all the information needed for proper performance reporting on the costs and results of its fines collection activities. Information on the costs and results of fines collection activities would be a basis from which to begin measuring the effects of the fines imposed - that is, the degree to which they are achieving their objective.

In the Public Accounts each year, the Department reports the fines revenue it collects on behalf of the Province. This information by itself, however, does not enable the Legislative Assembly or the public to determine how well, and how cost-effectively, the Department is collecting the fines imposed by the Province's courts. More information is needed, either in the Department's annual reports, or in other accountability reports, to give readers the complete picture.

Such reports could usefully summarize the number and total amounts of fines imposed during the year and the costs of collection. The reports could also show the number and value of fines that were satisfied by payment or other means, fines that remain outstanding, and fines that were written off as uncollectible. This information could be analyzed in a number of different ways, for instance by the type of fine, by the class of person fined (eg, young offenders or non-Alberta residents), and by jurisdiction

(municipal, provincial or federal). This information, together with information about the nature and costs of the Department's various collection activities, would provide a basis for assessing the success and cost-effectiveness of the Department's fines collection activities.

The Department's procedures for collecting fines imposed on out-of-province residents are largely ineffective. As a result, approximately 35,000 of these fines totalling more than $2 million remain uncollected each year. In most cases, collection efforts consist only of mailing one letter to the offender requesting payment. Motor vehicle-related fines are forwarded to Alberta Registries, but are invariably returned because out-of-province residents do not appear on Alberta's motor vehicles system.

In addition, roughly one third of all fines imposed under the Young Offenders Act remain uncollected. Collection of most young offender fines is pursued through the probation offices. As well, family and youth court administrators receive detailed reports of fines, but with little apparent effect on collections. While it is acknowledged that collecting these fines is extremely difficult in the circumstances, this underlines the importance of performance reporting in this area.

Information about fines collection results may also be of interest to the Alberta courts. For example, the Provincial Court of Alberta may be interested in periodic reports showing how successfully the Department is collecting the fines imposed. The municipalities on whose behalf the Department collects fines may also be interested in similar summary information about the fines imposed in their jurisdictions, and the Department's costs to collect them, as they are not charged for these services.

Management and control of fines

It is recommended that the Department of Justice improve the systems it uses to control and manage fines revenue.

The system used by the Department to record and manage fines needs to be improved to ensure that all fines imposed are recorded, or recorded promptly, and that information about unpaid or unsatisfied fines is accurate or easily accessible.

The Department's computer system does not capture all fines imposed by enforcement agencies through the issuance of tickets. This is evidenced by the number of payments that are received each year that cannot be matched to a record of a ticket having been issued. To be effective, the Department must, at a minimum, be provided with details of tickets that are issued by enforcement agencies. Payments for fines totalling approximately $75,000, representing about 1,000 tickets, are received annually that cannot

be matched to tickets issued by an enforcement agency. In the past, these receipts have been refunded to the payer. We understand that the Department has stopped issuing such refunds.

The Department sends some fines to Alberta Registries for collection. Although Alberta Registries has authority to require payment of these fines before issuing motor vehicle licences and registrations, the Department retains ultimate responsibility for their collection. Accordingly, it was expected that the Department would maintain a control record of fines held for collection by Alberta Registries. Yet, when my staff enquired, the Department had to contact Alberta Registries to determine that outstanding fines totalled $18 million. The Department had no convenient method of confirming the accuracy of this figure. By performing a computer match with the data stored on the Alberta Registries computer system, the Department could obtain assurance that all fines sent are recorded on the Alberta Registries system, that fines collected have all been remitted, and that the total outstanding figure is correct.

Once efforts to collect fines are discontinued, the fines are either removed from the system or, in the case of larger fines, are flagged as “concluded”, even though they have not been paid. This means that even if there are subsequent opportunities to collect a fine, such as when an offender enters the justice system again, there is no convenient way of determining whether a fine is still outstanding.

Information about unpaid fines might also be of interest to the courts when sentencing repeat offenders. At present, courts are provided with a history of the offender’s convictions, but are not provided with information about how or whether previous judgements were satisfied.

In March 1995, the Department completed a strategic planning study which concluded that major enhancements are needed to the Department’s administrative computer systems. These enhancements will commence when funding becomes available.

Financial reporting

I am pleased to report that the Department of Justice accepted my recommendation of accounting for fines revenues in accordance with generally accepted accounting principles and, at March 31, 1995, set up a receivable for the Province’s share of unpaid fines revenue of $14 million, together with a provision of $850,000 for amounts whose collection was considered doubtful.

Department of Labour
year ended March 31, 1995

There were no matters reported to management at the end of this year's annual financial audit.

Other entity

A financial audit was also completed of the **Joint Standards Directorate** for the year ended March 31, 1995.

Legislative Assembly Office
year ended March 31, 1995

None of the matters reported to management at the conclusion of the annual financial audit were selected for inclusion in this report.

Other entities

The financial transactions for the year ended March 31, 1995 of the following are included in the General Revenue Fund:

Office of the Auditor General
Office of the Chief Electoral Officer
Office of the Ethics Commissioner
Office of the Ombudsman

The financial statements of the Office of the Auditor General for the year ended March 31, 1995, were audited by a firm of Chartered Accountants appointed by the Standing Committee on Legislative Offices. The financial statements are included in this report starting at page 213, and are also published in section 5 of Volume 2 of the Public Accounts of the Province.

Department of Municipal Affairs
year ended March 31, 1995

None of the matters reported to management at the conclusion of the Department's annual financial audit were selected for inclusion in this report.

Alberta Social Housing Corporation
year ended March 31, 1995

Effective July 1, 1994, under the Alberta Housing Act, the name of the Alberta Mortgage and Housing Corporation was changed to Alberta Social Housing Corporation.

Excessive subsidies

Recommendation No. 29

It is recommended that the Alberta Social Housing Corporation procure rental accommodation for its Rent Supplement program at rates that do not significantly exceed average market rental rates.

The Corporation, under its Rent Supplement program, provides rent subsidies for low income tenants renting designated housing units from private sector landlords. The subsidy is the difference between the rent for the housing unit, negotiated by the Corporation, and the rent that the tenant is required to pay based on income.

During October 1994, the average rents paid for private sector housing units in Edmonton and Calgary subsidized under this program were 6.8% higher than the average market rents for the two cities. Applying this percentage to all the units in the program, rents paid exceed average rents by an estimated $900,000.

In Edmonton, 15 projects representing 142 housing units have rents that are up to 31% above the market average. Since Edmonton's apartment and townhouse vacancy rates were 8.9% and 6.9% respectively in October 1994, there should be sufficient alternative units available to avoid paying higher than average market rental rates.

The Corporation should consider renegotiating the rents with private landlords with a view to reducing subsidies. Where landlords prove to be inflexible, alternative accommodation at lower rents should be obtained.

Rent arrears

It is recommended that the Alberta Social Housing Corporation increase its efforts to collect rent arrears for the housing projects it manages directly.

Total rent arrears for directly managed properties were approximately $638,000 at April 30, 1995. The monthly rent for these properties was $138,000. Many tenants' rents were in arrears for 3 to 15 months.

The Corporation can terminate leases by giving tenants 14 days written notice if they do not pay the rents when due. However, generally no collection plans were developed that would allow delinquent tenants to make orderly payments of the rent arrears, nor was notice given to them to terminate the leases.

Also, the Corporation is not charging interest at 12% on rent arrears as provided for by the rental agreements.

Social housing projects

In the 1993-94 annual report (page 99), it was recommended that the Alberta Social Housing Corporation improve the systems used to control the operating costs of its social housing properties managed by agents. The Corporation could save substantial funds by determining if costs incurred by management bodies are reasonable in comparison to appropriate benchmarks.

I am pleased to report that the Corporation agrees with the recommendation and is in the process of developing and refining standard costs by major expenditure categories for its major housing programs.

I will continue to monitor the Corporation's progress in the development of systems and standard costs for controlling the operating costs of its social housing properties.

Property tax assessments

In the 1993-94 annual report (page 98), it was recommended that the Alberta Social Housing Corporation verify that the property taxes paid are based on property values appropriate for property tax purposes.

I am pleased to report that the Department of Municipal Affairs agrees with the recommendation and has taken action to address the concern. The Department is reviewing the property tax assessments for all its properties, including those owned by the Alberta Social Housing Corporation.

Land valuation

In the 1993-94 annual report (page 99), it was recommended that the Alberta Social Housing Corporation determine the net realizable value of its larger land holdings annually. For the 1994-95 year, the Corporation reviewed all its significant land holdings and made the appropriate adjustments in its financial records to net realizable value.

Improvement Districts' Trust Account
year ended December 31, 1994

Reservation of opinion

My auditor's report on the financial statements at December 31, 1994, contained a reservation of opinion.

The Trust Account has assumed a liability for the restoration of existing spoilage resulting from the past use of certain gravel pits. This liability is discussed in Note 16 to the financial statements. The liability, estimated at $3,100,000, has not been provided for in the financial statements of the Trust Account and in this respect the financial statements are not in accordance with generally accepted accounting principles. If the liability had been recorded, the excess of revenue over expenditure for the year and the surplus at the end of the year would have decreased by $3,100,000, and liabilities at December 31, 1994 would have increased by an equivalent amount.

Other entities

Financial audits of the following were also completed:

Alberta Planning Fund - year ended March 31, 1995
Special Areas Trust Account - year ended December 31, 1994

Department of Public Works, Supply and Services
year ended March 31, 1995

Accommodation

Background

At March 31, 1995, the Department owned approximately 200 general purpose office buildings with a total usable area of 420,000 m^2. The Department also paid lease charges of $75 million in 1994-95 for an additional 442,000 m^2 of usable office space in approximately 300 buildings.

The Department is responsible for accommodating approximately 28,000 government staff, including salary, wage and contract personnel. The Department expects allocated space for staff to average approximately 20 m^2 per employee, which includes a provision for common space such as hallways, reception areas and meeting rooms. Based on the current number of government staff and the Department's expectations for space usage, the total space requirement is approximately 200,000 m^2 less than the current inventory. On the basis of the current lease charges being paid by the Department, this surplus space is costing the government approximately $34 million per year.

In some instances, surplus space lies vacant. More commonly, however, surplus space exists in areas which are occupied, but under-utilized as a result of staff reductions. For example, many locations which met the target space allocation levels when occupancy began, now have space in excess of 25 m^2 per employee. A major challenge facing the Department is to identify opportunities to relocate and consolidate government staff to convert under-utilized space into vacant space which can then be terminated, subleased or sold.

Cost of services provided

In the 1993-94 annual report (page 102), it was recommended that the Department determine the cost of the accommodation it provides and seek legislative authority to charge tenants for the accommodation provided.

I am pleased to report that the Department has determined the cost of accommodation provided to each user and intends to provide this information to the tenants for 1995-96. The costs and benefits of charging for accommodation are being reviewed. I have discussed in greater detail (on page 171) the importance of providing users with this information in order that goods and services can be properly valued.

My staff will continue to monitor progress in implementing this recommendation.

Office space requirements

In the 1993-94 annual report (page 102), it was recommended that the Department improve its systems for determining the accommodation requirements of the government organizations it serves in order to reduce surplus space.

I am pleased to report that the Department has agreed with the 1993-94 recommendation and is taking action to identify surplus space. The Department's on-site inspections are now performed on an ongoing basis to obtain planning information on staff levels and to identify surplus space. This information is supplemented by communication with users to determine projected staff levels and space requirements.

My staff will continue to monitor progress in implementing this recommendation.

Subleasing and sale of surplus space

Recommendation No. 30

It is recommended that the Department of Public Works, Supply and Services continue to reduce the cost of holding surplus space.

A similar recommendation was made in the 1993-94 annual report (page 103).

I am pleased to report that the Department has agreed with the recommendation and is taking steps to reduce costs associated with surplus space. In 1994-95, the Department completed various relocation projects and lease terminations resulting in a net reduction of 28,000 m^2 of leased office space, representing cost savings of $3.8 million per year. The Department also sold approximately 10,000 m^2 of owned office space. In addition, approximately 9,000 m^2, located in 12 buildings, was successfully subleased and will generate sublease revenue of $820,000 per year.

The basic strategy of the Department's long-range accommodation plan is to relocate users as leases expire or surplus buildings are sold. However, the Department's ability to terminate leases and sell buildings may in certain cases be limited because the contiguous space required by some users is not available at other government locations. For this reason, in 1994-95, leases for approximately 19,000 m^2 of space were renewed, some for periods of one year or less to allow tenants time to restructure operations and relocate staff. In addition, approximately 4,000 m^2 of additional office space was leased because the Department could not accommodate new space requirements in existing properties.

The Department's long-range accommodation plan shows that space held will be reduced by approximately 130,000 m^2 by March 31, 1998. However, during the next three years, government space requirements are expected to further decrease as a result of downsizing and lower targets for allocated space.

Management has indicated that the current demand for subleased office space remains low. However, demand can be stimulated by offering attractive sublease rental rates and attractive locations. It is acknowledged that the cost savings through subleasing must be weighed against the costs of relocating staff. It is also acknowledged that the amount of surplus space available at certain locations may not be large enough, or the lease periods may not be long enough to make subleasing appropriate. In our view, the decision to sublease or sell should be based on achieving the most cost-effective use of government space.

Notwithstanding these limitations, the potential for cost recovery through subleasing is significant. Sublease revenue can be expected to be sufficient to recover at least half of the government's lease costs on subleased space. This Office estimates that savings of $8 million per year could be achieved if 50% of the total surplus space with lease terms over two years was to be subleased.

It is acknowledged that the Department must serve the needs of government users in providing office space. For example, a user may require space in a particular building for reasons such as its proximity to public transportation, despite the fact that surplus space may be available at other locations. However, in some instances, users' requests for particular space may be based more on preference than need. The Department is not in a position to make these determinations. Therefore, it needs the understanding and cooperation of the users, who must share responsibility with the Department for lowering overall government accommodation costs.

Telecommunications

Background

The Department of Public Works, Supply and Services has an overall responsibility to provide cost-effective telecommunications services to the government.

The Alberta Government Network (AGN) is a system of telephone lines for which line and equipment rental charges of approximately $15 million per year are incurred by the Department. AGN allows user departments and agencies to make long-distance calls within the Province without incurring toll charges. Provincial departments and agencies pay the cost of their non-AGN long-distance calls. These

charges are primarily for direct-dial and operator-assisted long-distance calls and "1-800" numbers provided for incoming calls. The cost of these calls to departments was approximately $5 million for the year ended March 31, 1995.

The Regional Information Telephone Enquiries (RITE) system is a service which allows the public to access government offices at no charge to the caller by dialling "310-0000".

Cost of services provided

In the 1993-94 annual report (page 105), it was recommended that the Department determine the full cost of AGN and charge users for this service.

I am pleased to report that the Department has agreed with the recommendation. The merits of having a private sector telecommunications company monitor usage and bill users for AGN service is being considered by a Cabinet committee formed to examine government-wide issues relating to information technology.

My staff will continue to monitor progress in implementing this recommendation.

Long-distance charges

It is recommended that the Department of Public Works, Supply and Services continue to help Provincial departments and agencies reduce long-distance telephone charges.

This recommendation was originally made in the 1993-94 annual report (page 105), and I am pleased to report that the Department has taken action to address two of the observations made in support of it:

- Incoming "310-0000" calls are now being routed through AGN resulting in savings of approximately $200,000 per year.

- All AGN centres have been upgraded to provide 24-hour automated service. We estimate the savings will be approximately $250,000 per year if AGN is used for outgoing calls to locations where this service was previously unavailable.

These savings have been made possible in large part by the efforts of the Public Affairs Bureau and I commend the Bureau for the support it has provided to the Department.

The Department has taken further action by providing monthly newsletters and communications to users in order to improve their use of AGN.

However, significant opportunities for further reductions in telecommunications costs exist. For example, overall government costs could be reduced by extending AGN service to government-funded entities such as regional health authorities, schools and universities. The demand for telecommunication services, particularly data transmission, by these entities will require substantial investment in shared network capacity. The Department indicates that the existing network may need to more than double in size to handle these additional users.

At present, government use of shared network services results in savings of approximately 50% compared with standard toll charges. If the capacity of the network is doubled, this could result in potential savings of $15 million per year for the extended stakeholders, and therefore the government. Proper planning will be critical in determining the requirements of the extended stakeholders and in ensuring that sufficient funds are budgeted for expansion of the network.

Existing users also continue to incur toll charges on outgoing calls by using direct-dial or operator assistance rather than AGN. We estimate that savings of $900,000 per year could be achieved if AGN is upgraded so that, wherever possible, outgoing calls are automatically routed through AGN. We are advised that the one-time cost of implementing this change will be approximately $600,000.

In addition, the Department may be able to convert many "1-800" lines to "310-0000" service, which can be routed toll-free over AGN, resulting in additional savings.

Other entity

A financial audit of the **Public Works, Supply and Services Revolving Fund** was also completed for the year ended March 31, 1995.

Department of Transportation and Utilities
year ended March 31, 1995

Guidance to reader

The Province has approximately 13,800 kilometres of primary highways, 15,000 kilometres of secondary highways and 130,000 kilometres of local roads. For the primary highways, the Department is responsible for construction, maintenance, motor transport safety services, and dangerous goods control. The exception is primary highways through most cities, where the Department provides grants for their improvements. The Department also provides financial assistance for the construction of secondary highways and local roads in rural areas. The Department supports utility services such as natural gas and electrical installations in rural areas. In 1994-95, the Department assumed responsibility for disaster recovery programs.

The Department is in the process of significantly restructuring how it delivers its programs.

I am pleased to note that the Department has initiated action on most matters previously reported in the annual report. I recognize that some previous recommendations will take time to action.

The audit observations and recommendations that follow identify improvements that can be made to the disaster recovery programs and the grant support programs.

Scope of audit work

In addition to the annual financial audit, the following work was completed:

- An examination of the 1995 Southern Alberta Disaster Recovery Program.

- An examination of grant funding provided to municipalities.

Grant administration

Recommendation No. 31

It is recommended that the Department of Transportation and Utilities require municipalities that receive grant payments for construction and maintenance of roads to demonstrate the effectiveness of use of public funds.

The Department provides grants to cities for construction and maintenance of primary highways and truck routes that run through them, and to other municipalities for secondary and rural roads. Under the Public Highways Development Act and the Municipal Government Act, these roads are under the control of the municipalities. Estimates for 1995-96 grant payments are

$45 million for rural roads, excluding transitional grants to newly incorporated municipalities, and $58 million for primary highways and truck routes in cities.

The Department provides grant funding to cities based on their population and to rural municipalities based on their population and other factors such as number of kilometres of roads. It is not clear, however, that these attributes are appropriate indicators of funding needs. For example, municipalities with a higher proportion of heavy truck traffic will need to expend relatively more funds to maintain their highway infrastructure.

The Department needs to ensure that reporting by municipalities reflects the effectiveness of the use of public funds. The Department does not have a means of evaluating how its grants to municipalities contribute to its transportation objectives, which include social and economic components. This is because municipalities only report on the nature of work performed rather than also reporting on the results achieved in terms of transportation objectives. Such results could include a reduction in collisions, improved flow of traffic, and improvement to the serviceability of the municipality's road network to a minimum standard established by the Department. The Department could use this information to determine if modifications are required to its funding.

Disaster assistance - receivables

It is recommended that the Department of Transportation and Utilities finalize its claim to the federal government for disaster assistance relating to the 1987 tornado.

As of March 31, 1995, the Department had an amount of $10.7 million receivable from the federal government regarding costs incurred in 1988 for flood damage in Slave Lake and in 1990 for flood damage in western Alberta. The federal government has delayed payment of these two claims pending receipt of sufficient evidence to support a claim from the Department for 1987 tornado damage in the City of Edmonton.

By resolving issues relating to the tornado claim, other long-outstanding significant amounts could be recovered.

Construction priorities

In the 1993-94 annual report (page 107), it was recommended that the Department improve its systems for ranking highway construction projects.

The Department has reviewed and ranked 1995-96 pavement rehabilitation projects in order to establish priorities for construction. The Department has also initiated a project to examine the system with a view to improving the methods for ranking and scheduling of

construction projects. I am pleased with the Department's response to this matter and will review the results of the Department's initiative in the future.

Environmental liabilities

In the 1993-94 annual report (page 109), it was recommended that the Department estimate the cost of restoration work required to comply with various environmental acts and report any liabilities that exist.

The Department has initiated a task force with members from Treasury, Environmental Protection, and other departments, to determine environmental obligations (see page 107). Also, it has undertaken remedial action at certain gravel pits and at its underground petroleum storage tank sites.

I will review the Department's future progress in quantifying and reporting its environmental expenditures, liabilities, commitments, and contingencies.

Gravel and other inventories

It is recommended that the Department of Transportation and Utilities quantify its inventories and identify those that are surplus to its needs.

A similar recommendation was made in the 1993-94 annual report (page 109).

The Department holds significant inventories that are not quantified. Its gravel inventories, for example, were valued at approximately $35 million at March 31, 1995. Its construction inventories have not been valued.

In April 1995, the Department initiated a project to identify all its inventories. This project also requires inventories surplus to the Department's program requirements to be identified for disposal. Initiatives such as contracting out maintenance activities will have a bearing on the Department's required inventory levels.

The Department also needs to improve its systems for recording gravel inventories. The Department maintains several computer and manual systems to account for and report on gravel inventories. As a consequence, information in each system overlaps and duplicates information in other systems. It was noted that such duplicated information on the quantities and value of gravel held was not consistent among the systems. Moreover, there are additional costs in data entry to maintain such separate systems. It is acknowledged that each user in the Department may not require the same level of detail or accuracy as other users. However, the Department should assess the cost savings potential from the use of a common system.

Commitments

In the 1993-94 annual report (page 110), it was recommended that the Department improve its procedures for determining its financial commitments.

I am pleased that no material errors were noted in the audit of commitments at March 31, 1995.

Capital assets

In the 1993-94 annual report (page 110), it was recommended that the Department improve the accuracy and completeness of the reported value of its capital assets.

The identification and valuation of capital assets is complicated by the nature of assets held by the Department and the decades over which these assets were acquired, mostly through construction activities. I am pleased to note that the Department has made progress in improving the accuracy and completeness of these capital assets. There are still certain areas that need to be addressed to ensure that capital assets are correctly identified and appropriately valued. I will review the Department's progress on these issues in future audits.

Land held for disposal

It is recommended that the Department of Transportation and Utilities accelerate the identification of land surplus to its needs and develop a plan to dispose of such land in an orderly way.

In the 1992-93 annual report (page 159), it was recommended that the Department improve its systems to manage its land holdings.

The Department holds land valued at approximately $40 million. It does not yet have comprehensive records indicating the location, specific value, and potential use of this land. Approximately 15% of the land by value has been reviewed to determine if any is surplus. The review of the remaining 85%, being $34 million in value, is anticipated to take another seven years. However, until surplus land is identified, it cannot be marketed or properly reported in the financial statements of the Province as land held for sale.

Other entities

Financial audits of the following were also completed:

Gas Alberta Operating Fund, and
Transportation Revolving Fund for the year ended March 31, 1995, and

Alberta Resources Railway Corporation for the year ended December 31, 1994.

TREASURY

Guidance to reader

The audit recommendations and observations that follow focus on three main areas.

The first area deals with the Province's consolidated reporting. The Province's consolidated financial statements present an overview of the Province's assets, liabilities, revenues and expenditures. These statements are important because they provide an understanding of the Provinces's overall financial position and operating results. Therefore, we consider recommendations to improve the Province's consolidated reporting to be critical. The recommendations are included under Treasury because this Department is responsible for the preparation of the consolidated financial statements.

In this first area, I comment favourably on the timeliness of reporting, the production of the new *Measuring Up* (June 1995) report and the progress made in the preparation of a consolidated budget. Further, I acknowledge the improvements made to the consolidated statements in 1994-95 and make recommendations for further improvements in the areas of revenue and program costs. Finally, I comment briefly on the audit of the General Revenue Fund and my responsibilities for Crown-controlled organizations.

The next area covers a number of issues which fall under Treasury responsibility. Recommendations for improvements are made in the areas of revolving funds, the government's proposed new accounting system, pensions, governance of the Alberta Heritage Savings Trust Fund, risk management and investment management. Finally, I comment briefly on the status of my prior recommendation for a review of the Heritage Fund.

The third area deals with Treasury Branches to whom I have made three recommendations. The first deals with loan monitoring and the second and third are designed to help improve performance through a better understanding and use of marketing. I also acknowledge amended legislation which allows for the creation of a Board of Directors.

Timeliness Of Reporting

The government set June 30, 1995 as the target date for release of the 1994-95 consolidated financial statements. The Provincial Treasurer released the audited statements on June 23, 1995. The Province continues to provide the earliest reporting in Canada. I congratulate the Treasury Department, and all other departments and agencies, on their collective achievement in meeting the deadline.

In addition to achieving the deadline, the management of the Treasury Department are to be congratulated on their achievements regarding the quality of the financial statements. Since my appointment as Auditor General, I have attended several meetings, including a recent national conference, with my provincial and federal counterparts. At all of these meetings, the Alberta experience is looked at and discussed in very positive terms and our Province is seen as a leader in government reporting.

Measuring Up (June 1995)

In addition to the consolidated statements, the document *Measuring Up - first annual report by the Government of Alberta* was released on June 23, 1995. This document provides information on 22 core measures of government performance in the core businesses of People, Prosperity and Preservation. The document also includes information on 47 important trends which fall outside the responsibility of government or any single department or agency. These trends are identified for education, health and wellness, social investment and so on.

This is another "first in the nation" achievement by the management of the Treasury Department.

I reported to the Provincial Treasurer on June 16, 1995 on the results of applying specified auditing procedures to core performance measures. My report is included on page 7 of *Measuring Up* (June 1995).

Consolidated Budget

Comparison with financial statements

In the 1993-94 annual report (page 114), it was recommended that the annual consolidated budget be prepared on the same basis as the consolidated financial statements. The public needs a comprehensive picture of the government's revenue and expenditure plans which can be compared with the actual financial results achieved.

Budget '95 issued in February 1995 included a discussion paper on this topic in which the government stated its commitment to present *Budget '96* on a fully consolidated basis.

In May 1995, the Treasury Department sponsored an advisory panel and work group of senior managers in government to move this matter forward through July 1995.

In August 1995, the Provincial Treasurer informed me that a fully consolidated budget will be implemented in *Budget '96*.

The management of the Treasury Department are to be congratulated on the progress made to date on this improvement to accountability reporting which will likely be another first in the nation.

Again, as a relatively new legislative auditor, I am very impressed with the leadership provided by the Province in financial reporting. Consolidated budgeting is another subject that my legislative auditor colleagues in other jurisdictions have discussed with me at meetings, as they look for solutions to improve financial accountability in their jurisdictions.

Consolidated Financial Statements of the Province
year ended March 31, 1995

The Province's consolidated financial statements are published in Volume 1 of the Public Accounts. The notes to the consolidated financial statements explain the accounting policies and reporting practices employed in preparing them.

On June 16, 1995, I was able to report without reservation on the Province's consolidated financial statements for the year ended March 31, 1995. My report is reproduced on page 194 of this report.

The Workers' Compensation Board dissociated at January 1, 1995

In *Budget '95*, the government stated its intention to introduce legislation in 1995 to move The Workers' Compensation Board (WCB) outside the government reporting entity.

The amendment Act was introduced and came into force on June 1, 1995. In the consolidated financial statements at March 1995, the financial results of WCB have been included up to an amount to eliminate the previously included accumulated deficit of WCB. There is clear disclosure in Schedule 16 that WCB was dissociated at January 1, 1995, which date does not coincide with the June 1, 1995 coming into force of the amendment Act.

Had the WCB continued to be accounted for as a commercial enterprise, it would have been necessary for the consolidated financial statements to disclose that the net assets included under equity accounting were net assets that were completely inaccessible to the government. The WCB surplus is in substance "owned" by the employers in the Province who provided the funds that created it.

Although some may argue that the government controls the WCB's net assets (surplus) by virtue of the fact that the Board is still appointed by the Lieutenant Governor in Council, I am persuaded, on the basis of substance over form, that the decision to exclude the WCB surplus from the consolidated financial statements is appropriate. However, I must caution at this point that were the WCB to revert to a deficit position, I would need to assess whether any annual and accumulated deficit should be included in the Province's consolidated financial statements.

Improvements in the past year

The Treasury Department continued to make significant improvements to the consolidated financial statements during 1994-95. For example, there was expanded disclosure on derivatives used to manage the interest rate risk and currency exposure associated with the Province's unmatured debt. The disclosure on guarantees and indemnities was expanded to include expiry dates and details of guarantee limits. Also, a new schedule was prepared which identifies the organizations which are consolidated.

Future improvements

The following recommendations and observations identify further desired improvements to future consolidated financial statements.

Revenue

Recommendation No. 32

It is recommended that the Treasury Department record all revenue in the consolidated and General Revenue Fund financial statements on the accrual basis.

Under the present accounting practice, certain revenue is recorded on a cash basis, that is, when the revenue is collected. The accrual basis is more accurate since revenue is allocated to the period in which it is earned rather than when it is received.

Revenue currently recorded on a cash basis arises from corporate income taxes, motor vehicle and operator licences, grazing leases and energy rentals and fees.

The Auditor General made the same recommendation in the 1993-94 annual report (page 116), and the government accepted it in principle.

I recognize that the accrual of corporate income taxes is complex, and the matter has been reviewed in some depth in consultation with my staff. I have recently proposed a possible solution to the Treasury Department's Budget and Management staff, and will be discussing it further with them. If my proposal is accepted, corporate tax revenue could be reported on the accrual basis for 1995-96.

With respect to other revenue sources mentioned above, the departments responsible for their collection are able to calculate the revenue on the accrual basis. Therefore, these revenues can be reported on the accrual basis in 1995-96.

Program costs

Recommendation No. 33

It is recommended that valuation adjustments be allocated to program costs in the consolidated and General Revenue Fund financial statements.

Losses arising from guarantees and indemnities, and provisions for losses, doubtful accounts and loans, which in 1994-95 amounted to $279 million, are included in the consolidated Statement of Revenue, Expenditure and Net Debt as an expenditure described as valuation adjustments.

In last year's report (page 116), the Auditor General pointed out that valuation adjustments are not associated with a particular program or department. Including losses from guarantees and indemnities and

other provisions with a department's other program costs would enable program decisions to be based on complete costs.

The government has accepted the recommendation. The Treasury Department has acknowledged the need to allocate costs to programs where practicable and will address the costs and benefits of implementing the recommendation.

I will continue to examine progress on this matter.

Capital assets

The government intends to record and amortize the Province's capital assets in 1995-96. Presently, a note to the consolidated and General Revenue Fund financial statements discloses the estimated cost and amortization of capital assets.

In last year's report (page 117), the Auditor General commented on the significant progress made in 1993-94 towards accounting for capital assets. Further progress has been made by departments in the past year towards having reliable and accurate capital asset records. The implementation of a common capital asset system for the Departments of Public Works, Supply and Services, Economic Development and Tourism, and Transportation and Utilities shows the positive initiative of those departments.

During 1994-95, the value of capital assets was refined for changes including assets expected lives, overheads and capitalization minimum value. This refinement process may occur over some years because the subject is complex, for example, the amortization of highway infrastructure. Since Alberta will be the first government in Canada, and one of the first in the world, to capitalize and amortize highways and roads, there is only limited practical experience to draw on.

At a recent meeting with management of the Department of Transportation and Utilities, the amortization of a highway's roadbed, initial paving and re-paving was discussed. My staff concluded that use, particularly by heavy trucks, affected the life of a road to a greater extent than the passage of time. Since, currently, amortization of roads is based on time rather than use, I encouraged the Department to search for improved ways to account for the operating costs of Alberta's road system.

I will continue to review any future refinements until the implementation of accounting for capital assets in 1995-96.

Reporting entity

In the past two annual reports (1993-94 page 117), the Auditor General noted that the consolidated financial statements do not include the financial results, position and cash flows of all

Provincial agencies, such as Provincially owned universities, colleges and technical institutes. It was recognized that changes to the healthcare system introduced by the Regional Health Authorities Act would also likely affect the consolidated entity.

Recently, the Treasury Board has expressed the view that there is no significant public benefit from expanding the reporting entity to include Provincially owned universities, colleges and technical institutes, and regional health authorities. The inclusion of these entities in the Province's consolidated financial statements will now be postponed for some time.

In my view, these organizations fit within the government reporting entity, based on Public Sector Accounting and Auditing Board (PSAAB) guidance issued by the Canadian Institute of Chartered Accountants.

Method of consolidation

The consolidated financial statements do not include the total assets, liabilities, revenues and expenditures and cash flow of the Province's commercial organizations. In 1994-95 these entities reported revenues and expenditures of about $2 billion, and assets and liabilities of about $10 billion.

Instead, these organizations are included in the consolidated financial statements under the equity method. This means that their financial reporting in the consolidated statements includes net profits of $800 million and the Province's net equity position of $200 million. Schedule number 8 to the consolidated statements shows the financial impact of the commercial enterprises.

In past annual reports (1993-94 page 119), the Auditor General suggested that the Treasury Department should be working towards a full consolidation of these entities with appropriate disclosure of segmented information on the Province's activities, for example in banking, insurance and lending.

The Treasury Department has not accepted the suggestion. The Department's views and our response were discussed in last year's annual report.

I have reviewed the arguments on both sides and believe that there is a strong common-sense basis for the Office's views. However, I do recognize that the suggestion advocates a view which has at present the support of only one-third of the PSAAB associates who responded to the recent draft paper on Defining the Government Reporting Entity. Accordingly, I accept the views of my colleagues and will not press this matter further with the Treasury Department until PSAAB's current position changes.

General Revenue Fund
year ended March 31, 1995

The financial statements of the General Revenue Fund report the revenues and expenditures of the 17 government departments and the Legislative Assembly, including its Legislative Officers, together with the financial assets and liabilities they administer. Issues affecting government departments are reported under the name of the department.

I was able to report without reservation on the General Revenue Fund financial statements for the year ended March 31, 1995.

Crown-Controlled Organizations

Details of Crown-controlled organizations are disclosed in Volume 3, section 3, of the 1994-95 Public Accounts. During the year, the Province disposed of its controlling interest in North West Trust Company.

Section 16 of the Auditor General Act provides the Auditor General with access to information concerning these organizations if the Auditor General is not the auditor of the organization.

I am pleased to report that all of the information which I required to properly fulfil my obligations concerning these organizations has been made available to me.

Treasury Department
year ended March 31, 1995

In addition to the annual financial audit, the following work was completed:

- An examination of the policies and procedures used by the Department to manage risks associated with investments and liabilities.

- A review of the Province's 1994 annual filing with the US Securities and Exchange Commission.

- The participation of Senior Directors from my Office on a number of advisory and working groups established by the Treasury Board or the Department. These included:

    · *Measuring Up* (June 1995), (first annual report),

- Monitoring and Analysis project group,
- Departmental Financial Statements study group and steering committee,
- Departmental Financial System/Central Financial System Replacement group, and
- Fully Consolidated Budget group.

I am pleased that our professional resources are being sought and used in this manner.

Revolving funds

Recommendation No. 34

It is recommended that the Treasury Department reassess the need for revolving funds in order to reduce costs and simplify administration.

In the event that revolving funds continue, it is recommended that their financial statements include all material costs of operations.

Revolving funds are established within departments to provide services or to sell materials to other branches within the department or to the public. Examples are the promotion of tourism and the provision of learning resources and supplies.

Alberta Treasury's accounting policy guidelines for revolving funds state that the objective of each program within a revolving fund is to provide goods and services on a break-even basis. The policy directs that users should be charged for the goods and services they receive, and that the charges should be sufficient to cover all costs, including direct costs, overhead, interest to the General Revenue Fund (if applicable), and a provision for amortization. By not including all costs, funds' customers will pay less than the full cost of the services they receive, and funds will not achieve true cost recovery. Further, users of a fund's financial statements will be unable to determine the degree to which a fund's customers are being subsidized.

In last year's annual report (page 122), the Auditor General noted that revolving funds are not working as intended and are not necessary. I concur that the government should be able to fully cost its programs and services without the expense of operating revolving funds.

Material operating costs continue to be excluded from the revolving funds. In the case of some revolving funds, it is possible that unrecorded costs are approaching the significance of recorded costs. All of the funds' financial statements disclose that certain costs,

such as accommodation, are not included but are instead recorded in the General Revenue Fund. The exclusion of material costs from a fund's financial statements has the potential, if such costs are of a sufficient magnitude, of presenting the auditor with a situation wherein he should not render an opinion on the financial statements due to the incompleteness of those financial statements. It is in this context that I have made recommendations to the government.

The government has accepted the recommendation to reassess the need for revolving funds and the Treasury Department has agreed to consider this matter as the government's financial administration is re-engineered.

While the continued existence of revolving funds is being considered, I believe there is some urgency in capturing the full cost of the services being provided. Accordingly, I made recommendations to this effect to the managements of the following funds which do not at present include all significant administration and operating costs in their financial statements:

Agriculture, Food and Rural Development Revolving Fund
Community Development Revolving Fund
Economic Development and Tourism Revolving Fund
Personnel Administration Office Revolving Fund
Transportation Revolving Fund

I will monitor progress on this matter.

Government's new accounting system

Recommendation No. 35

It is recommended that the Treasury Department closely monitor the strategy, progress and implementation of the government's proposed new accounting system.

The nature of government accountability has dramatically changed as a result of recent legislation, such as the Government Organization Act, Government Accountability Act, Deficit Elimination Act, Balanced Budget and Debt Retirement Act and changes to the Financial Administration Act.

Departments now have greater responsibility and more autonomy. In turn, the Treasury Department is now expected to monitor and advise, rather than control. However, the Provincial Treasurer is still responsible for all matters related to the Province's financial affairs.

In line with these changes, there has been a common recognition in government departments of the need for up-to-date information

technology to provide accurate, current financial and other information. This information would enable them to better meet the challenges of their individual responsibilities by developing and implementing business and financial strategies, for example, with "what if" scenarios. Also, departments would be more able to recognize earlier the need to refine strategies.

In August 1995, PSC Payment Systems Corporation (PSC) made a proposal to the Senior Financial Officers (SFOs) of departments for a new Integrated Financial System (IFS) to replace the existing Departmental/Central Financial System (DFS/CFS).

If accepted, this proposal will:

- fast-track implementation of IFS for an April 1, 1996 introduction date for departments, that is within a six-month period;

- change the information technology from a traditional mainframe computer application to a client/server architecture application, using client workstation personal computers which are networked to a central server computer; and

- use a PeopleSoft product, namely, Release 5 of the public sector version of Financials which was planned to be available for public release at the end of September 1995.

Each of these factors has significant risks. At this time, my staff have identified a number of concerns, including:

1. The role of the Treasury Department has been to monitor events, but there is no detailed specification of the requirements for quarterly and annual financial information.

2. Although the implementation time-frame is very aggressive, departments have not developed comprehensive plans for the installation of the new software. There are numerous tasks that would affect that timetable.

3. There may be significant resource constraints for departments which may affect their ability to implement the new software in the time-frame envisaged.

4. It is not known if the proposed new product will function effectively over the Alberta Government-wide Area Network or departmental Local Area Networks.

5. The Province will be one of the first to implement the proposed product on the scale being planned.

6. Careful consideration should be given to the need to maintain the present system as back-up to the new IFS system for some months after April 1996.

As the project develops, it would be expected that the concerns identified above and others would be addressed and solutions found.

However, in summary, my main concern at this time is that the implementation of the new IFS system carries the risk that the government may lose control of its business and financial plans, including the ability to make payments on time. This is a crucial time for the Province and the decision makers must know precisely what is happening in their departments. Any problems arising from the proposed new IFS system might prevent departments and the government from achieving the targets for which they are accountable. The overall credibility of the government is at risk.

I believe that the Treasury Department has two key roles:

1. To ensure that departments identify their requirements and prepare realistic implementation plans, with proven fall-back positions and achievable target dates.

2. To establish its own central requirements, and plans to achieve them, so that the Province's quarterly and annual consolidated financial and other accountability reports are prepared within the government's required timetable.

To be effective in those roles, it is strongly suggested that senior staff of the Treasury Department be members of any management committees or supervisory groups formed as the project progresses.

The progress of the proposed new system is dynamic and evolving daily. The preceding observations are based on information available at this time.

Senior Financial Officers

In conjunction with the implementation of the government's proposed new IFS system, the Treasury Department will likely also have a unique opportunity to work with and advise departmental Senior Financial Officers (SFOs) and to monitor the financial activities of the departments for which the SFOs are responsible. As stated above, this results from the changed role of the Treasury Department and other departments as a result of the restructuring of government accountability arising from the recent new legislation.

As a result of the restructuring, the Treasury Department will have to place significantly more reliance on SFOs to provide timely and accurate consolidated financial information on a quarterly and

annual basis. The capability of SFOs will be a critical factor in achieving their own departmental targets as well as the Treasury Department's and the government's target for timely and accurate financial information and reporting.

I will monitor developments in this area.

Special Forces Pension Plan

Under the Public Sector Pension Plans Act, the Province is responsible for any unfunded liability for pre-1994 service that remains after the employees and employers have made their contributions.

The 1993-94 annual report (page 122), commented on the need for the Province to prepare a plan to address the growth in the unfunded liability in the Special Forces Pension Plan. Based on an actuarial valuation as at December 31, 1991, the unfunded liability of this plan was projected to grow from $129 million to $2.6 billion by 2036. The Auditor General was concerned that under existing funding arrangements, the unfunded liability for the Special Forces plan will continue to increase because interest which is accumulating on the liability is not being fully funded.

A new actuarial valuation as at December 31, 1993, changed the previous estimate of $129 million to an unfunded liability of $13 million. This was the result of more favourable assumptions than used for the previous valuation. The new estimate of $13 million is estimated to grow to $540 million by the year 2036.

I will continue to monitor the status of the unfunded liability and the need for the Province to establish a plan to address the growth in the unfunded liability.

Pension liabilities

Recommendation No. 36

It is recommended that Alberta Pensions Administration assist the Public Sector Pension boards to improve the information communicated to employers.

It is also recommended that the Treasury Department review the manner in which the pension liability is reallocated to employers within the Public Sector Pension Plans.

Unfunded pension liabilities exist as a result of insufficient contributions being collected from employers and employees from the time plans were first established until December 31, 1991. At March 31, 1992, the unfunded liabilities of the Local Authorities, Public Service, Public Service Management, Universities Academic, and Special Forces pension plans were estimated at $2.8 billion.

In 1993, legislation was changed. Current service must be fully funded and the prior service unfunded liabilities are being eliminated through a cost sharing arrangement between the government, and employers and employees within the respective plans.

At March 31, 1993, the Province recorded its pension liabilities in the consolidated financial statements. Provincial entities, as employers, followed in 1994. Other employers within the various plans have also begun to record their share of the pension liability in their respective financial statements.

Unfortunately, not all employers understand why pension liabilities should be recorded in their financial statements. Nor do all employers understand how their pension liabilities are estimated and how they may change from year to year. In particular, it is not well understood that the liability will likely grow for many years before falling.

Ideally, the pension liabilities should have been allocated to those employers who benefited from the service of the employees whose pensions were underfunded. The most practical solution, however, was to calculate the initial allocation to employers based on their employees' pensionable salaries at March 31, 1992. The value of the liability allocated to the employer thus reflected an estimate of what the employer would ultimately pay based on the cost-sharing arrangement.

Presently, many employers are downsizing and the change in their share of a plan's pensionable salaries can be significant during periods of rapid change in the workforce. As their share changes, so does their proportionate share of future payments. Employers who downsize more quickly than others within the same pension plan shift a portion of their pension liability to the other employers in the plan.

Likewise, the decision of the government to privatize certain organizations impacts the remaining employers within the plan. As an example, when the Alberta Liquor Control Board was privatized, the Board's pension liability was reallocated to the remaining employers in those public service pension plans in which the Board employees were participants.

The Treasury Department should review the impact of the recent changes in government entities to determine if improvements are needed in the way the liability is allocated to employers. I believe it would be preferable if the organization making the decision to alter its workforce was to bear the cost of that decision. The ability to

shift costs to another organization without that organization's concurrence seems inappropriate.

Whether changes are made or not, Alberta Pensions Administration needs to work with the pension boards to ensure employers have sufficient information to understand the nature of their pension liabilities.

Pensions administration

In annual reports of the past few years (1993-94 page 127), this Office has expressed concern that information in the Contributor System of Alberta Pensions Administration (APA) is not up-to-date and is incorrect. This information is used to calculate pension payments and the Province's actuarial liability for pensions.

To keep the information up-to-date, APA requires about 600 employer organizations in the pension plans to provide audited annual returns specifying each contributor's pensionable salary and period of service. These audited returns need to be received and reviewed punctually by APA, but there have been significant delays in obtaining returns from many employers. For the past two years, about 100 employers have been late in sending annual audited returns to APA.

My staff is working with APA to determine if contributor information can be verified in a more cost-effective way. One strategy is to replace the annual audited return process. Instead, APA staff would directly verify employer information.

We will continue to work with management to find a cost-effective solution.

Alberta Royalty Tax Credit

In the Auditor General's 1993-94 annual report (page 123), it was recommended that in keeping with the government's initiatives on accountability, the goal for the Alberta Royalty Tax Credit Program be restated to include the expected result and the related performance measures. Officials from Treasury and Energy are actively developing a more appropriate goal and relevant performance measures. Also, they have involved staff from my Office in the discussions.

I am pleased with the progress to date, and will continue to monitor the situation until the recommendation is fully implemented.

Risk management policies and guidelines - assets

Recommendation No. 37

It is recommended that the level of acceptable investment risk be established for the Alberta Heritage Savings Trust Fund.

One of the Treasury Department's objectives is to effectively manage the Province's assets and liabilities. Effective management means providing the maximum return on investments or minimum cost of debt, consistent with the level of risk that is assumed.

Based on the review of the Alberta Heritage Savings Trust Fund completed during the year, new objectives and investment strategies are being developed for the Fund. The Fund's new investment objectives and strategies should define acceptable risks and tolerance to fluctuations in the return earned on the Fund's investments.

The Department should then ensure that specific policies, such as policies which might limit the Fund's foreign currency and low grade securities exposure, and industry or geographic location investment concentrations, are consistent with the level of risk to be assumed. Further, risk management strategies should take into account the Province's related debt risks.

The Canada Deposit Insurance Corporation has developed a comprehensive set of Self-Assessment Criteria to assess its risk management process. Although the criteria were developed primarily for lending institutions, the Department may find the criteria useful in identifying risks and developing appropriate risk policies.

Risk management policies and guidelines - liabilities

The Treasury Department is nearing completion of a project which evaluates the risk associated with the Province's current debt portfolio. This will allow the Department to develop a debt portfolio which will provide the least cost of debt for the amount of risk the government is willing to assume.

Investment performance

Recommendation No. 38

It is recommended that the Treasury Department include additional performance measurement criteria in its investment objectives and provide additional performance information on the investments that it manages.

The Treasury Department manages the investments of five major pension plans, The Workers' Compensation Board, and various funds. In total, the market value of the investments managed for these entities is approximately $20 billion. It was reported in the 1993-94 annual report (page 124) that additional performance

criteria should be established in relation to actual market performance. Such additional information would assist in assessing how well the investments are being managed.

The government accepted the recommendation. However, I understand that in the absence of the respective governing bodies establishing investment strategies which include performance criteria based on actual market performance, the Treasury Department will continue to set a general objective of maximizing returns.

I will be reviewing the progress of the various pension boards and The Workers' Compensation Board in establishing appropriate performance measurement criteria and will report any concerns to the relevant boards.

The balance of the investments under the management of the Treasury Department are primarily those held by the Alberta Heritage Savings Trust Fund. As indicated above, the Treasury Department is currently working to redefine the objectives and investment strategy of the Fund. I believe that the new investment objectives of the Fund should include performance measurement criteria in relation to actual market performance. In the absence of establishing performance measurement criteria in relation to actual market performance, market indices can only be used as a point of reference for comparison. Although the Fund's 1995 Annual Report provides market indices for comparison to actual returns, management believe such a comparison is not a fair measure of performance.

In addition, performance measurement criteria should be established for all investments in the Fund. This would include the investments held in the Canada Division and the Alberta Investment Division.

Mortgage investments

The 1993-94 annual report (page 126), recommended that the Treasury Department obtain current information to manage and value mortgage investments.

The recommendation was accepted, and there has been some improvement in the quality of information obtained on these investments. However, the information is still not complete. I understand that under existing agreements, much of the information is difficult to obtain. The Treasury Department has indicated that all new agreements will require the provision of the suggested information. I will continue to monitor the Department's progress in obtaining appropriate information.

Investment management services

It is recommended that as the Treasury Department develops a business plan for the investment management division, it examine the need to provide other Provincial organizations with investment management services.

In the 1992-93 annual report and in the 1993-94 annual report (page 126), it was recommended that the Treasury Department identify Provincial organizations that could benefit from investment management services. It had been observed that some Provincial organizations that manage funds may not be maximizing their investment returns while minimizing their investment risks. Although the Department has done some preliminary work, it has not yet identified those Provincial organizations which could benefit from the provision of investment management services.

The Department is currently reviewing the needs of current users for investment management services and will be developing a business plan accordingly. As part of this review, the Department should examine the cost-effectiveness of providing investment management services to other Provincial organizations. I will review the Department's progress as the business plan is developed.

Systems management

It is recommended that the Banking and Cash Management Division involve the Investment Management Division and the Controller's Office in identifying issues, establishing target dates and priorities, and testing prior to implementing any changes to the investment management system.

During the year, my staff noted various problems relating to a new investment management system resulting from the new system being implemented in a short time period. It was also noted that the implementation activities of the Banking and Cash Management Division, the Investment Management Division and the Controller's Office were not properly co-ordinated. The problems identified by my staff through the year have since been corrected.

To ensure that future issues relating to investment management services are dealt with promptly and appropriately, and that the best service is provided, it is important that Treasury Department's divisions work together effectively. I believe that defining roles and responsibilities will help in co-ordinating their efforts. The involvement of the Investment Management Division and the Controller's Office will be critical to making sure that future systems changes deal adequately with concerns and are tested sufficiently.

Alberta Heritage Savings Trust Fund
year ended March 31, 1995

Review of the Fund

The need for a review of the Alberta Heritage Savings Trust Fund was recommended in previous years' annual reports of the Auditor General. I am pleased to report that a review was completed in the current year by an all-party five-member Review Committee. Using a report issued by the Committee in March 1995, the Treasury Department is now working to define new objectives for the Fund.

Treasury Branches Deposits Fund
year ended March 31, 1995

In addition to the annual financial audit, the following work was completed:

- An examination of the systems used to administer the marketing department.

- An examination of the controls to prevent fraudulent activities on customer accounts.

Loan monitoring

It is recommended that in order to improve loan monitoring, Alberta Treasury Branches compile and use statistics on breaches of credit covenants and other loan alerts.

The prompt follow-up of breaches of credit covenants should help management in determining and taking action necessary to prevent loans from deteriorating further.

Management at Alberta Treasury Branches currently receive reports of loans that are in arrears and on which certain types of credit covenants, such as a delay in the receipt of financial statements, have been breached. The usefulness of this information would be improved, however, if it included such factors as inadequate security margins, down-grading of customers' credit status, and late monthly inventory and accounts receivable listings.

Conveniently available information of this nature could assist management in the early detection of deteriorating loans. Early detection should prompt timely recovery action and result in lower loan losses. On a summarized basis, such information would help senior management, and later the Board of Directors, assess overall credit risk and the effectiveness of management's control systems.

Alberta Treasury Branches agrees with this recommendation and is developing suitable systems which will be implemented in 1996.

Performance indicators

It is recommended that Alberta Treasury Branches develop performance indicators to provide a basis for evaluating the success of its marketing activities in meeting corporate objectives.

Measurable performance indicators would help Alberta Treasury Branches to evaluate the success of its various marketing initiatives, as well as in developing effective action plans for future years.

Alberta Treasury Branches' strategic business plan contains situational analyses and action plans. Each action plan identifies the department responsible for implementation, together with the expected cost. However, most of the marketing department's action plans do not identify performance indicators. In the absence of performance indicators, it is not clear whether the actions taken have been cost beneficial in meeting corporate objectives.

As an example, one of Alberta Treasury Branches' objectives is to increase its sales of Registered Retirement Savings Plans. The marketing department is responsible for the promotional campaign to achieve this objective. However, in the absence of measurable performance indicators including costs, it is unclear the degree to which the various marketing strategies such as direct mailing, brochures/posters and media advertising have been cost effective in contributing to the success of the campaign.

Marketing department

It is recommended that the marketing department pursue strategies to further improve the relevance of the services Alberta Treasury Branches provides.

To ensure that its activities are directed at maximizing market potential, the marketing department should be:

- initiating and monitoring more actively the marketing carried out in the branches. This would include coordinating the work of the head office marketing staff and the general offices marketing staff to ensure that appropriate marketing services are being provided to the branches;

- evaluating the success of Alberta Treasury Branches' various marketing initiatives in relation to the performance of other financial institutions. This should help to identify the need for future marketing initiatives;

- increasing the benefits of the marketing database by encouraging more frequent updates of information, and perhaps arranging for branches to have online access;

- encouraging staff to communicate their ideas for improving marketing strategies by making more use of the staff suggestion program. This program, while not restrictive of the subjects upon which staff can comment, tends to attract suggestions mainly on operational and procedural matters. Feedback on marketing strategies might be valuable because front-line staff are particularly well placed to assess customers' needs and concerns; and

- increasing its awareness of customer expectations and concerns by making more use of the Customer Viewpoint Cards. The marketing department is seldom notified of the information received at branches from customers. Since this information relates to customer ideas and feedback, it could assist the marketing department in designing marketing initiatives.

Board of Directors

In the 1993-94 annual report (page 129), the Auditor General suggested that the Provincial Treasurer consider the advantages of establishing an advisory board for Alberta Treasury Branches.

I am pleased to report that the Treasury Branches Amendment Act gives the Provincial Treasurer the authority to create a board of directors for Alberta Treasury Branches. My staff has provided the Acting Superintendent with some general comments about the duties and constitution of a Board of Directors.

Trust Funds

The Province administers public money over which the Province has no power of appropriation. It is therefore not included in the Province's consolidated financial statements. At March 31, 1995, trust funds under administration amounted to $13,614 million. Summarized information of the funds making up this amount is provided in Note 5 to the consolidated financial statements.

Other entities

Financial audits of the following were also completed:

473654 Alberta Ltd. - period ended December 31, 1994
(Reports the liquidation activities related to certain assets and liabilities assumed from NovAtel Communications Ltd.)
496072 Alberta Ltd. and NFI Finance, Inc., Combined Financial Statements - period ended December 31, 1994
(496072 Alberta Ltd. facilitates the management and orderly disposition of certain assets acquired from NovAtel Communications Ltd.)
Alberta Heritage Foundation for Medical Research Endowment Fund - year ended March 31, 1995
Alberta Heritage Scholarship Fund - year ended March 31, 1995
Alberta Insurance Council - year ended March 31, 1995
Alberta Municipal Financing Corporation - year ended December 31, 1994
ARCA Investments Inc. - year ended March 31, 1995
Consolidated Cash Investment Trust Fund - year ended March 31, 1995
Credit Union Deposit Guarantee Corporation - year ended December 31, 1994
Farm Credit Stability Fund - year ended March 31, 1995
N.A. Properties (1994) Ltd. - year ended March 31, 1995
Orion Properties Ltd. - year ended December 31, 1994
S C Financial Ltd. - year ended December 31, 1994
Small Business Term Assistance Fund - year ended March 31, 1995
The Alberta General Insurance Company - year ended December 31, 1994
The Alberta Government Telephones Commission - year ended December 31, 1994
Treasury Revolving Fund - year ended March 31, 1995

Pension related:

Pension Plan Administration Fund - year ended March 31, 1995

For the year ended December 31, 1994:
Local Authorities Pension Plan
Management Employees Pension Plan
Public Service Management (Closed Membership) Pension Plan
Public Service Pension Plan
Special Forces Pension Plan
Universities Academic Pension Plan

The irrigation districts are independently incorporated with no direct accountability to the Legislative Assembly. Therefore, their audited financial statements are not published in the Public Accounts of the Province.

The financial statements of the fourteen irrigation districts were audited to various year-ends within the 1994-95 fiscal year:

Aetna Irrigation District
Bow River Irrigation District
Eastern Irrigation District
Leavitt Irrigation District
Lethbridge Northern Irrigation District
Macleod Irrigation District
Magrath Irrigation District
Mountain View Irrigation District
Raymond Irrigation District
Ross Creek Irrigation District
St. Mary River Irrigation District
Taber Irrigation District
United Irrigation District
Western Irrigation District

On May 17, 1995, the Legislative Assembly amended the Irrigation Act. One effect of the amendment is that the Auditor General is no longer the statutory auditor of irrigation districts. Boards of directors of irrigation districts must now appoint their own auditors for the 1995 fiscal year and thereafter.

SECTION 12(b) AUDITS

Pursuant to section 12(b) of the Auditor General Act, the Auditor General may, with the approval of the Standing Committee on Legislative Offices, be appointed auditor of organizations other than Provincial departments, funds and agencies. For accounting periods ended within the 1994-95 fiscal year, the Auditor General acted as auditor of the following organizations:

Alberta Children's Hospital Research Centre
Alberta Hospital Edmonton Foundation
Calgary Regional Health Authority
Capital Health Authority
Fairview College Foundation
Foothills Hospital Employees' Charity Fund
Foothills Hospital Foundation
Grande Prairie Regional College Foundation
Olds College Foundation
Palliser Health Authority
The Friends of University Hospitals
The Trustees of the Academic Staff Benefits Plans of The University of Alberta
University of Alberta Hospitals Staff Benevolent Fund
University of Alberta Hospitals Staff Charities Fund

Financial statements

Annual financial audits of the following for the year ended June 30, 1995, were in progress at the date of this report:

Fairview College Foundation,
Grande Prairie Regional College Foundation, and
Olds College Foundation

Legislative Mandate

The Office of the Auditor General of Alberta was established in 1978 and operates in accordance with the Auditor General Act. The Auditor General is the auditor of all government departments, funds containing public money, and Provincial agencies.

The Act deals with my responsibilities as Auditor General by stating what I must and can report, to whom, and when.

Section 18 reports

In section 18 reports I state whether, in my opinion, the financial statements present fairly the financial position, results of operations and changes in financial position of the Crown.

The section 18 report on the Province's 1994-95 consolidated financial statements is reproduced on page 194 of this report. Similar reports were issued on the financial statements of all entities of which I am the auditor. These reports are attached to the related financial statements, most of which are published in the Public Accounts of the Province.

Section 19 reports

The report you are reading is my section 19 report for 1994-95. Section 19 reports are annual reports to the Legislative Assembly on the work of my Office. These reports include audit observations and recommendations arising from that work, together with any other matters that I believe should be brought to the attention of the Legislative Assembly.

Section 17 reports

Under section 17 of the Auditor General Act, the Legislative Assembly or the Executive Council may ask me to perform special duties. Whether those duties result in reports, and to whom the reports are issued, depends on the terms of the request. During the 1994-95 fiscal year, I received no requests to perform a special duty under section 17.

Section 20 reports

The Auditor General can report under section 20 to the Legislative Assembly on any matters of importance or urgency which, in his opinion, should not be delayed until the next annual report.

No reports have been issued under section 20 of the Act since the last annual report.

Section 28 reports

Reports issued under section 28 of the Act are known as management letters. The purpose of management letters, as explained more fully on page 191 of this report, is to communicate to management recommendations for improving financial administration.

Management letters are addressed to the deputy minister or senior executive officer of the audited entity. A copy is sent to the minister responsible for the entity except for those Provincial agencies referred to in section 2(5) of the Financial Administration Act.

Mission

The following statement continues to guide the work of the Auditor General's Office:

> **The mission of the Office of the Auditor General of Alberta is to add credibility to the government's financial reporting and to improve the financial administration of the Province.**

Adding credibility

Each set of financial statements included in the Public Accounts reflects management's view of the entity's financial position at year end, the results of its operations and the changes in its financial position.

My responsibility is to bring professional judgment and skill to the examination of these financial statements in order to provide an opinion on them. The result is an Auditor's Report designed to add credibility to the assertions of management.

The Public Accounts Committee acts on behalf of the Members of the Assembly in examining the government's management and control of public resources. My annual report, and the audited financial statements in the Public Accounts, are used by the Committee in its examination of the use and control of public resources.

Improving financial administration

My Office helps the Legislative Assembly, the government and its managers focus on the issues critical to sound financial administration. My Office, therefore, undertakes in-depth examinations of a selection of management control and information systems each year. The recommendations that arise are designed to promote economy and efficiency, and improve reporting so that decision makers are provided with reliable and relevant information.

Types of audit

Throughout section 3 of this report, the term "financial audit" is used. In this context, a financial audit encompasses:

- audit procedures considered necessary to support the expression of an opinion on financial statements,

- a review of action taken in response to previous audit observations and recommendations, including those reported to the Legislative Assembly, and

- an examination of transactions and activities examined for other auditing purposes to determine whether they comply with the significant financial and administrative authorities that govern them.

For some audit entities, work additional to the financial audit was completed. Such additional work involves examining systems in depth. The scope of the additional audit work undertaken for 1994-95 is identified in section 3 of this report.

All audit findings, conclusions and recommendations arising from all types of audit activity relating to 1994-95 have been reported to management.

Reporting Process

The audit observations and recommendations contained in this report have undergone a rigorous process aimed at providing all concerned with opportunities to challenge or provide input.

Meetings (exit conferences and audit committee meetings) were held at the conclusion of audits to discuss significant audit findings and concerns. The matters discussed depended on the nature of the audit, but included typically the form and content of financial statements, valuation provisions and allowances, the accounting policies employed, recommendations for systems improvements, and observed instances of non-compliance with legislative authorities. These meetings were attended by representatives of this Office and senior financial and other management officials of the audited entities.

The main purposes of these meetings were to ensure that senior management and boards understood the audit findings, to discuss recommendations, and to provide opportunities for management comment and reaction before the audited financial statements and the letter to management were issued. Minutes of these meetings were prepared and circulated by my staff to minimize the risk of misunderstandings on matters discussed.

Audit recommendations judged to be of concern to management were incorporated into management letters to the responsible deputy minister or senior executive officer. Copies of management letters were forwarded to the appropriate minister, except for those

addressed to Provincial agencies referred to in section 2(5) of the Financial Administration Act.

Subsequently, recommendations considered important enough to be reported to ministers, Public Accounts Committee members, other MLAs and the public were selected for inclusion in this report. When determining significance, I take into account the nature and materiality of the matter relative to the individual entity and the government as a whole.

Finally, before this annual report was published it was made available to the Audit Committee. Also, all ministers and deputy ministers or chief executive officers were informed of observations that relate to areas for which they are responsible.

The Provincial Treasurer on behalf of the government responded publicly to the numbered recommendations in the 1993-94 annual report on December 21, 1994. Of the 32 numbered recommendations, 27 were accepted, four were accepted in principle, and one was placed under review.

Reservations In Audit Reports On Financial Statements

Section 19(2) of the Auditor General Act requires the Auditor General to provide details in his annual report of reservations of opinion in reports issued on financial statements. This report shows that 11 such reservations were issued:

Five reservations of opinion were because the financial statements of:

- Children's Health Foundation of Northern Alberta
- Grande Prairie Regional College Foundation
- Mount Royal College Foundation
- Olds College Foundation
- University Hospitals Foundation

include revenue which could not be audited for completeness in accordance with generally accepted auditing standards.

One reservation of opinion was because, as discussed more fully on page 85, the financial statements of the Agriculture Financial Services Corporation are not prepared in accordance with generally accepted accounting principles.

Three reservations of opinion were because, as described more fully on page 76, the financial statements of:

- Grant MacEwan Community College
- Mount Royal College
- Northern Alberta Institute of Technology

inappropriately implied that liabilities relating to vacation pay and pension were not incurred in the normal course of operations.

One reservation of opinion was because, as described more fully on page 151, the financial statements of the Improvement Districts' Trust Account are not prepared in accordance with generally accepted accounting principles because the Trust Account did not provide for the costs of restoration of existing spoilage resulting from the past use of certain gravel pits.

One reservation of opinion was because, as described more fully on page 51, the Alberta Tourism Education Council received revenue and incurred expenses which were outside the scope of the Tourism Education Council Act.

In all other cases, I was able to report without a reservation of opinion.

Other Information Included In Audit Reports On Financial Statements

Additional information

Auditor's Reports for the financial statements of:

- Economic Development and Tourism Revolving Fund
- Environmental Protection Revolving Fund

contained additional information describing transfers of assets and liabilities between funds which were not authorized by legislation.

Although the Financial Administration Act does not provide for transfers between funds, in my opinion, there was no inappropriate use of public funds.

Inadequate disclosure

Auditor's Reports for the financial statements of:

- Alberta Microelectronic Centre, and
- Telecommunications Research Laboratories

as described more fully on pages 70 and 71, disclosed that these organizations did not provide appropriate salary, related benefits, or budget information disclosure as required by the Treasury Board or the Provincial Treasurer.

Report Under Section 18 Of The Auditor General Act

Section 18 of the Auditor General Act requires that I report to the Legislative Assembly on the financial statements of the Crown for each fiscal year. The report is to include an opinion on the financial statements and any other comments related to my audit of the financial statements, and to state my reasons for any reservation of opinion.

Opinion on the financial statements

My Auditor's Report to the Members of the Legislative Assembly on the financial statements of the Crown for the year ended March 31, 1995, is attached to the consolidated financial statements and reads:

"I have audited the consolidated statement of assets, liabilities and net debt of the Province of Alberta as at March 31, 1995 and the consolidated statements of revenue, expenditure and net debt and changes in financial position for the year then ended. These financial statements are the responsibility of Treasury Department management. My responsibility is to express an opinion on these financial statements based on my audit.

"I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

"In my opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Province of Alberta as at March 31, 1995 and the results of its operations and the changes in its financial position for the year then ended in

accordance with the disclosed basis of accounting as described in Note 1 to the consolidated financial statements."

The Auditor's Report was dated June 16, 1995.

Public Accounts

Audit

The Public Accounts of the Province are published in four volumes:

Volume 1 - Consolidated financial statements of the Province of Alberta

Volume 2 - Financial statements of the General Revenue Fund, revolving funds and regulated funds

Volume 3 - Financial statements of Provincial agencies, commercial enterprises and Crown-controlled corporations

Volume 4 - Financial statements of universities, public colleges, technical institutes and health boards and authorities

All of the information in the Public Accounts is covered by Auditor's Reports except for the Provincial Treasurer's Overview in Volume 1, financial statements of certain health authorities in Volume 4, and sections 2 and 5 of Volume 2 as follows:

Section 2 of Volume 2 contains details of General Revenue Fund expenditure and revenue for each department. I have not expressed an audit opinion on this information. The information is extracted from the General Revenue Fund's financial records which were audited for the purpose of expressing an opinion on the General Revenue Fund financial statements. The audit opinion on the General Revenue Fund financial statements explains that the work done was sufficient to obtain reasonable assurance whether the financial statements as a whole were free of material misstatement. The work was not intended to obtain assurance as to whether the information contained in individual departmental statements in section 2 of Volume 2 was free of material misstatement.

Section 5 of Volume 2 contains supplementary information required by legislation or by direction of the Provincial Treasurer. I have expressed an audit opinion on the Salary and Benefits Disclosure information and on the financial statements of seven pension plans included in this section. I have not expressed an audit opinion on the remainder of the section but I have determined that the information is consistent with the audited information in the Public Accounts.

Consolidated financial statements

The 1994-95 consolidated financial statements report on the Province's financial condition, results of operations and cash flows. Volume 1 of the Public Accounts also includes "An Overview" prepared by the Provincial Treasurer.

The consolidated financial statements are an aggregation of most, but not all, of the entities controlled by the Province of Alberta. They combine the operating results, financial positions and cash flows of all the entities whose financial statements are published in Volumes 2 and 3 of the Public Accounts, including for example, the General Revenue Fund and the Alberta Heritage Savings Trust Fund. The consolidation, however, does not include certain Provincial agencies such as universities, public colleges and technical institutes, and regional health authorities and school boards.

Accounting Principles and Auditing Standards

The principal source of generally accepted accounting principles and auditing standards is the Handbook of the Canadian Institute of Chartered Accountants. In addition, the Public Sector Accounting and Auditing Board of the Institute issues accounting and auditing statements. These statements apply to and guide accounting and auditing in the public sector.

Accounting principles

Generally accepted accounting principles is the term used to describe the basis on which financial statements are normally prepared. The term generally accepted accounting principles encompasses not only specific rules, practices and procedures relating to particular circumstances, but also broad principles and conventions of general application. Generally accepted accounting principles are established to encourage the consistent and fair disclosure of financial information.

The financial statements of most of Alberta's Provincial entities are prepared in accordance with generally accepted accounting principles. In the main, the exceptions to generally accepted accounting principles relate to the method of accounting for capital assets.

As is customary with government accounting, the General Revenue Fund and consolidated financial statements of the Province of Alberta are not prepared in accordance with generally accepted accounting principles. The basis of accounting is explained in a note to the financial statements, and is, in my opinion, appropriate.

Auditing standards

The work of the Auditor General's Office is carried out in accordance with the auditing standards and recommendations published by the Canadian Institute of Chartered Accountants and its Public Sector Accounting and Auditing Board.

Our contribution

Apart from providing comments on draft accounting and auditing standards, the Auditor General's Office contributes directly to professional accounting organizations:

Peter Valentine, FCA, is a member of the Board of Governors of the Canadian Comprehensive Auditing Foundation.

Andrew Wingate, CA, is a member of the Auditing Standards Board of the Canadian Institute of Chartered Accountants. He is also a member of the Not-for-profit Organizations Task Force.

Jim Hug, CA, is a member of the Practice Review Committee of the Institute of Chartered Accountants of Alberta.

Kelly Aldridge, CMA, served as Chairman of the Professional Conduct Committee of the Society of Management Accountants of Alberta.

Doug Wylie, CMA, is a member of the Practice Review Committee of the Society of Management Accountants of Alberta.

Role And Responsibilities

The Office of the Auditor General exists to serve the Legislative Assembly and the people of Alberta.

Accountable to the members of the Legislative Assembly, we are responsible to members of the public who want assurances that the government's financial reporting is credible. Consequently, our core opinion work is performed to add credibility to the financial reports of organizations accountable to the Assembly. But our legislators want more, and rightly so. In effect, we are charged with making recommendations to improve the economic and operational health of the Province.

How do we achieve this? In short, by focusing on two key strategies:

- helping to link performance information with financial reporting; and
- providing recommendations for business practices that work.

In this new era of financial administration, the Province needs auditors who can help public agencies achieve clear financial reporting that shows the cost and effect of operations. The Auditor General's Office does just that.

Too often the auditor is seen as an adversary of management. I believe we should approach our audit work in ways which allow us to work with our clients to help improve their business processes and reporting practices. They deserve the very best available client service from their auditor. Since joining the Office last March, I have met with most of our clients personally to stress the importance we place on client service.

Our message to our clients is a simple one. We are here to help, by working with our clients in resourceful ways that are mutually beneficial. My Office is seeking to forge new relationships with its clients—old and new.

An Independent Audit Function

As an officer of the Legislature, the Auditor General is independent of the government. The Office was established in 1978 and operates in accordance with the Auditor General Act; the origins of the former Provincial audit office go back to 1905. Our links to the Legislature are through two committees: The Standing Committee on Legislative Offices, and the Public Accounts Committee. The Provincial Audit Committee, with private sector members, provides another link with our clients. A list of the members of these committees appears on page 209.

Our mandate - to audit and report

The mandate of our Office is to audit all government departments and funds, Provincial agencies and the consolidated financial statements of the Province.

An audit in the private sector concludes with an opinion on the client's financial statements, and a letter to management identifying issues which have arisen during the audit. It may contain recommendations to improve internal control and other business practices. The management letter may be discussed with an audit committee, but the auditor has no obligation to report to the public.

My obligation as Auditor General is similar, but goes further. Public organizations are funded with public money. That is why the Auditor General Act requires me to make public the results of my audit work, including my recommendations for improvements, and any identified misuse of public funds.

This requirement to report can sometimes make it difficult to establish positive relationships with our clients. Some public servants feel that reporting my audit findings and recommendations to the public is not helpful to them personally, because a recommendation may reflect badly on their past performance. My own view is that one never moves forward unless one recognizes how to improve upon the past. No manager needs to apologize for being smarter today than they were yesterday.

When we do report our findings, we make it our practice, wherever possible, to identify systems weaknesses and not to criticize individuals. We try to restrict our comments to what happened, the system weakness that allowed it to happen, and how improvements can prevent recurrence of problems.

I believe we can continue to fulfil our mandate to report publicly, while building and maintaining strong positive working relationships with our clients.

Helping to report on performance

A major focus of our recommendations work is to help clients find appropriate ways to measure and report on results. Currently, there are large areas of government activity where the cost and effect of services are not usefully measured. Correcting this deficiency has the potential to produce significant savings. Governments everywhere continue to struggle to link spending with quantifiable results, and in this area Alberta is determined to be at the forefront.

Legislators, deputy ministers and managers need performance measures that are easily understood and that lead to wise decisions. Our Office is committed to help find the solutions. We will do this by working in partnership with our clients to determine simple and clear measures to increase efficiency.

Recommendations for good business practices

Currently, approximately 20 per cent of the audit function is devoted to generating recommendations to improve accountability reporting or operational procedures. In the Office's three-year business plan, we pledged to increase our recommendations work to 30 per cent, in keeping with the wishes of the Legislative Assembly to improve financial accountability. This goal will be achieved through efficiency and the redirection of resources, not by increasing resources.

Eventually, the Office intends to split its time equally between recommendations work and the time required to support the opinion function. This move signals a shift in the core business of the Office of the Auditor General towards making a more significant contribution to improving public financial administration and financial reporting.

The intent is to maximize time available for recommendation work because this is where significant progress in accountability can be made. Furthermore, developing quality recommendations takes time—both to analyze information and to consult with clients.

Accountability

Accountability can be defined as an obligation to answer for the execution of one's defined responsibilities. The Government of Alberta is among the first in Canada to undertake to measure and report the cost and effect of the services it provides and funds. As accountants we know that such measurement invariably leads to reduced cost and improved service.

Our own accountability

Our commitment is to provide value for money. This is achieved through the deployment of qualified and experienced people on the service team, an efficient and effective audit tailored to the specific

needs of the client, effective planning, and co-operation and communication with client management. We have an in-depth understanding of best practice in public sector auditing and reporting.

The Office of the Auditor General has already begun to assess and report the cost and value of our opinions and recommendations so that we are truly accountable for our own operations.

We are in complete agreement with and fully support the government's significant advances in implementing accountability in all of its activities.

My Office has participated in this program in that:

- we have included, in our March 31, 1995 audited financial statements, a number of performance measures (see page 225);

- we have carried out specified auditing procedures on the 1994-95 core measures included in *Measuring Up* (June 1995);

- we have encouraged all of our clients to include performance reporting in their financial statements; and

- we are supporting the development of systems to enable reporting of all significant costs in the financial statements of organizations. We believe that reporting the full costs of outputs is necessary for financial management and accountability.

In concert with these very important initiatives, my Office advised our clients that we would begin to charge an audit fee for the cost of our attest audit services.

The purpose of this new policy was twofold. Firstly, it would help all organizations account for the cost of all of their inputs, resulting in an accurate reporting of the costs of their outputs. And secondly, it would implement a fiscal discipline in my Office such that economies and efficiencies appropriate for the Office are achieved in a manner that enables the Office to continue to be accountable to the Legislature.

The notice to our clients of this new policy has caused substantial comment, and I have some very serious concerns about the reaction to the new policy. Many organizations do not yet subscribe to the full costing concept. This is particularly true for a number of the larger departments and revolving funds.

In the notice to our clients, we indicated that audit fees collected by this Office would be deposited in the General Revenue Fund, thereby enabling the funding of the additional audit costs borne by them. However, the almost unanimous reaction has been that we are downloading our costs on the organizations without providing them with a source of funding.

While the implementation of the new policy is a goal of the Office, and is supported by the Standing Committee on Legislative Offices and the Provincial Treasurer, clearly it is premature for the following reasons:

- we (that is the government and my Office) have not established an appropriate mechanism to account for and fund the cost of attest audits performed by, or under the direction of, my Office; and

- an appropriate communication system with our clients has not been effected.

In light of the foregoing it is my intention to postpone the implementation of this portion of "full costing" until such time as there is clear support for the concept and an appropriate mechanism has been developed for budgetary and accounting purposes.

Our financial statements

We believe that in order for performance information to be really useful, it should be audited. The best way to make sure this happens is to include accurate performance information in audited financial statements. Our most recent financial statements, for our year ended March 31, 1995, are located on page 213. They have changed substantially from previous years, and go a long way towards improving our performance reporting, and thus our accountability.

In previous years, the financial statements of the Office have consisted of a single statement of revenue and expenditure. Our statements now include a balance sheet, statement of operations, and statement of changes in financial position. Assets are now capitalized and amortized and the cost of preparing an Annual Report is reported in the year in which the Report is issued. In this way, the cost of the output is matched with the delivery of the output. Accrued vacation pay has been recorded as a liability, and a

pension liability has been recorded. Costs paid by other government departments or agencies, such as accommodation, are included for the first time. These changes mean that our statements now conform with generally accepted accounting principles. More importantly, they mean that we are able to report the full cost of our operations, so that we can meaningfully compare our costs to those of other auditors.

The financial statements contain supplementary performance information designed to assist in evaluating the Office's performance. I have explicitly asserted in the financial statements, (note 3(f)), that this quantifiable information is relevant and reliable. And our auditors have attested to that assertion. The additional performance information is in three schedules at the end of our financial statements. They are:

- Schedule of output costs by ministry
- Schedule of recommendation work and status of recommendations
- Schedule of other performance information

If you are interested in assessing the performance of this Office, I invite you to review our financial performance in relation to our budget, along with the above three schedules. They represent our first effort at more comprehensive performance reporting.

Internal accountability

Improvements in technology are helping us to perform better, and to report our performance. Over the past year we have developed our management information systems to allow us to manage our resources in a more businesslike way. Our operational systems are fully integrated with our financial systems. This allows us to accurately compute the cost of our work and the outputs we produce. It also allows us to attribute the costs and revenues associated with our audits to the individual employees who do the work. We produce individual contribution statements for each auditor, which are used to help us assess their personal contribution to achieving our business plans. We believe such performance information is necessary to ensure that we appropriately recognize performance, and that this in turn leads to improved productivity.

The Future - People And Technology

We are an Office of professional accountants. We take our role extremely seriously because of its direct impact on the efficiency of government spending. Government productivity is directly linked to economic prosperity. Hence, the Office of the Auditor General is in a position to make significant contributions to the future of the Province of Alberta.

But to be successful, we need highly developed professional knowledge. We must be able to help our clients to solve their business problems. We need to attract, train, and retain the very best available professionals. If we are to continue to provide a useful service, we need to provide these people with technologies that provide access to new techniques and opportunities for improving business practices.

Our people

Our Office is a practising office of the Institute of Chartered Accountants of Alberta. Most of our more than fifty professional staff are Chartered Accountants, but we also employ many Certified Management Accountants and Certified General Accountants. We invest heavily in the training of students to become professionals in all three recognized accounting designations. Over the last four years more than thirty students have become professional accountants while working for the Office. Our Office is an excellent place for accounting students to obtain the experience they need to qualify as professionals. They have opportunities to work with a wide variety of clients, both large and small.

Our Office watchwords are—Professionals Committed to Solutions. After our people qualify as professionals, we continue to support them in expanding their knowledge and skills, so they can continue to help provide the solutions necessary to improve the financial administration of the Province.

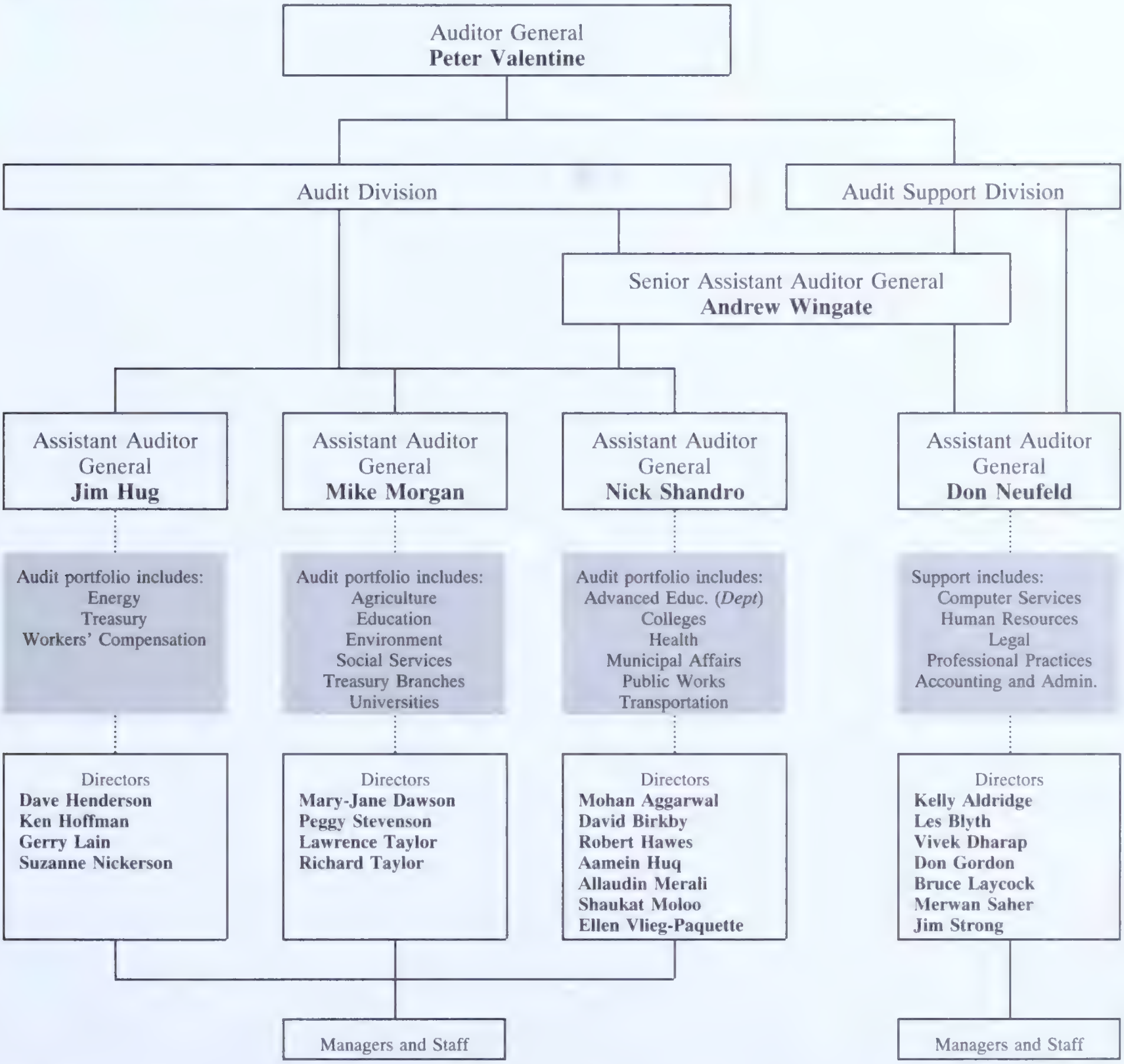
Using technology to improve performance

The Office has long been an advocate of using technology to improve the efficiency of our audit work. In the early 1980s we developed our own "PROBE" auditing software to allow us to analyze client computer data. We still use it on most of our audits, along with many other computerized audit tools. We have also invested in computer technologies to improve our performance reporting and other business processes. But the use of technology to provide access to up-to-date, world-wide data bases remains largely untapped. In the coming year we will invest in developing our computer network to open up these resources for easy access by our auditors. We are convinced that our future performance reporting will demonstrate the prudence of these investments in the development of our people and our information systems.

I am proud of the work of my Office, and this report is the result of much hard work by all of my staff. Their dedication continues despite the difficult times of cutbacks in staff and salaries, and the consequent increase in their workload.

We look forward to working with our existing clients and to developing relationships with new clients over the next several years, as collectively we work to help Alberta prosper.

The organization of the Office of the Auditor General is as follows:



The Office of the Auditor General is administered by the Management Committee whose members are:

Peter Valentine, FCA	Jim Hug, CA	Don Neufeld, CA
Andrew Wingate, CA	Mike Morgan, CA	Nick Shandro, CA

The Office has two main operating divisions:

Audit: Responsible for carrying out the opinion work on financial statements and making recommendations. Each assistant auditor general heads up a team responsible for a portfolio of the Office's approximately 200 clients. Each team plans and executes its own audit functions.

Audit Support: This division provides a variety of administrative and audit-related services essential to the effective functioning of a professional services firm. Human resources management, computer systems, security, professional practices, legal advice, and coordination of the Auditor General's annual reports all are taken care of by the Audit Support Division.

Standing Committee on Legislative Offices

Reports issued under section 19 of the Auditor General Act are tabled in the Legislative Assembly by the Chairman of the Standing Committee on Legislative Offices. Members of the Committee on May 17, 1995, the day the Assembly last adjourned were:

Ron Hierath, MLA	Chairman
Roy Brassard, MLA	Deputy Chairman
Frank Bruseker, MLA	
Gary Dickson, MLA	
Gary Friedel, MLA	
Yvonne Fritz, MLA	
Ken Kowalski, MLA	
Don Massey, MLA	
Gary Severtson, MLA	

Audit Committee

Before being tabled, annual reports are made available to an Audit Committee in accordance with section 24 of the Act. The members of the Audit Committee as at the date of this report, all of whom were appointed by Order in Council, are:

Dr. Norman Wagner — Chairman of the Audit Committee
Chairman of the Board
Alberta Natural Gas Company Ltd.
Calgary

Jack Halpin, CA
Partner
Halpin, Anderson, Mayer, Chartered Accountants
Calgary

Brian McCook, CA
Senior Vice-President
Nelson Lumber Company Ltd.
Lloydminster

Janice Rennie, CA
Director,
Nova Corporation of Alberta, Edmonton Power, Weldwood of Canada Ltd., and Bellanca Development Ltd.
Edmonton

Fred Snell, CA
Partner
Ernst & Young, Chartered Accountants
Calgary

Ralph Young
Vice-President and Director
Melcor Developments Ltd.
Edmonton

The Hon. Jim Dinning
Provincial Treasurer of Alberta

Agents

The Auditor General's Office has continued the policy of utilizing the services of firms of private sector chartered accountants. These firms act as my agent under section 10 of the Auditor General Act, and their contributions in supplementing the staff resources of the Auditor General's Office are gratefully acknowledged. Agents acting in respect of the fiscal year ended March 31, 1995, were as follows:

Arthur Andersen & Co.
Bevan, Halbert, Ginet, Ens and Gerrard
Coopers & Lybrand
Craig Davies Collins
Dawson Berezan & Partners
Deloitte & Touche
Doane Raymond
Ernst & Young
Hudson & Company
Johnston, Morrison, Hunter & Co.
KPMG Peat Marwick Thorne
Ladell Perry
Mills Unrau Gerlock
Price Waterhouse
Roy, Solbak, Walsh & Co.
Watkinson, Hanhart, Duda, Dorchak
Young, Parkyn, McNab & Co.

In order to properly understand the Province's financial condition and results, it is necessary to understand the terminology used in the Public Accounts. For example, SURPLUS, DEFICIT, AND NET DEBT are terms with particular meanings in the consolidated financial statements of the Province. Unfortunately, the terms are often misused by those not familiar with them.

The following table presents a summary of the consolidated statement of revenue, expenditure and net debt for the fiscal year ended March 31, 1995, and the consolidated statement of assets, liabilities and net debt at March 31, 1995.

	In millions	
	1995	1994
Revenue	$ 16,067	$ 14,337
Expenditure	(15,109)	(15,721)
Surplus (deficit) before pension provisions	958	(1,384)
Pension provisions	(286)	(296)
Surplus (deficit)	672	(1,680)
Net debt at beginning of year	(13,379)	(11,699)
Net debt at end of year	$(12,707)	$(13,379)
Assets	$ 18,845	$ 18,207
Liabilities	(31,552)	(31,586)
Net debt	$(12,707)	$(13,379)

Surplus/Deficit

A **surplus** results when the Province's consolidated revenue exceeds expenditure for a fiscal year.

A **deficit** results when the Province's consolidated expenditure exceeds revenue for a fiscal year.

For the purposes of the Deficit Elimination Act, specific obligations under defined benefit pension plans are excluded from the determination of the deficit. As a result, the consolidated statement of revenue, expenditure and net debt reports a surplus (deficit) before pension provisions and the surplus (deficit) after pension provisions.

Some commentators use the words surplus and deficit without the preface "accumulated" to refer to an accumulated surplus or deficit over time. It is therefore important to be alert to the context in which the words surplus and deficit are being used.

Net Debt/Consolidated Net Debt

Annual surpluses and deficits accumulate and are reported as **consolidated net debt**. The terms **net debt** and **consolidated net debt** are used interchangeably. Net debt represents the difference between the Province's assets and the liabilities (1995 $12,707 million, 1994 $13,379 million). The term "accumulated deficit" is sometimes used to describe the total of all annual deficits and surpluses incurred over time, and is synonymous with "net debt".

The net debt arises from the consolidated financial position of about one hundred Provincial entities. These include, the General Revenue Fund, revolving funds, the Alberta Heritage Savings Trust fund and other regulated funds, Provincial agencies and Crown-controlled corporations, including those agencies and corporations designated as commercial enterprises. Provincial agencies such as universities, public colleges, technical institutes, school boards, and regional health authorities are not included.

The assets of the Province include cash and marketable securities, receivables, investments, equity in commercial enterprises, loans and advances, and inventories. Capital assets such as land, buildings and infrastructure are currently excluded. The Province intends to record capital assets on its balance sheet at the end of the 1995-96 fiscal year.

The liabilities of the Province include accounts payable, unmatured debt, pension obligations, other accrued liabilities and equity in Alberta Municipal Financing Corporation.

Debt

The word debt is used by commentators to describe the total liabilities of the Province (1995 $31,552 million, 1994 $31,586 million). However, the word debt is also used to describe the unmatured debt (1995 $21,577 million, 1994 $22,062 million), which is a part of the Province's liabilities. It is therefore important to be alert to the context in which the word debt is being used. But note that debt, however used, is significantly different from net debt (1995 $12,707 million, 1994 $13,379 million) determined by netting the assets and liabilities of the Province.

Common misuse of terminology

Net debt is sometimes used incorrectly to describe the result of netting all liabilities except pension obligations (1995 $5,352 million, 1994 $5,066 million), and assets. Excluding pension obligations results in understating the net debt.

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

FINANCIAL STATEMENTS

MARCH 31, 1995

AUDITORS' REPORT

To the Chairman, Select Standing Committee on Legislative Offices:

We have audited the balance sheet of the Office of the Auditor General as at March 31, 1995 and the statements of operations and changes in financial position for the year then ended. These financial statements are the responsibility of the Office's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Office as at March 31, 1995 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Kingston Ross Pasnak
Chartered Accountants

May 23, 1995
Edmonton, Alberta

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

BALANCE SHEET

AS AT MARCH 31, 1995

	1995	1994 (Note 2)
ASSETS		
Audit fees receivable	$ -	$ 950
Accountable advances	9,978	10,872
Work in progress (Note 4)	1,139,133	1,340,510
Due from General Revenue Fund	1,789,653	2,150,975
Capital assets (Note 5)	616,690	177,100
	$3,555,454	$3,680,407
LIABILITIES AND DEFERRED CONTRIBUTIONS		
Accounts payable	$ 615,468	$ 692,165
Accrued vacation pay	518,277	547,823
Pension liability (Note 6)	2,291,005	2,263,319
Deferred expended capital contributions	130,704	177,100
	$3,555,454	$3,680,407

The accompanying notes and schedules are
part of these financial statements.

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

STATEMENT OF OPERATIONS

FOR THE YEAR ENDED MARCH 31, 1995

	1995		1994
	Budget (Note 7)	Actual	Actual (restated)
Expenses:			
Manpower (Note 9):			
Salaries and wages	$ 6,100,000	$5,115,169	$ 6,504,186
Employer contributions (Note 6)	1,073,600	895,037	1,029,208
Professional fees and development	147,130	97,288	109,412
	7,320,730	6,107,494	7,642,806
Supplies and services:			
Agent fees	1,948,335	1,612,144	2,098,380
Office accommodation	612,460	612,460	607,399
Professional services and fees (Note 10)	251,050	535,556	228,769
Amortization of capital assets	129,958	129,958	125,351
Travel	160,300	141,017	139,440
Materials and supplies	180,478	131,664	129,090
Computer services	261,003	83,349	114,925
Office equipment rental	35,000	30,865	30,950
Repairs and maintenance	17,795	13,198	11,944
Miscellaneous	16,500	10,268	11,668
	3,612,879	3,300,479	3,497,916
Expenses before work in progress adjustment	$10,933,609	9,407,973	11,140,722
Change in Annual Report work in progress		85,974	69,596
Total expenses for the year		9,493,947	11,210,318
Less audit fee revenue		(793,351)	(1,011,378)
Net cost of operations for the year		$8,700,596	$10,198,940
Financed by:			
General Revenue Fund		$8,624,637	$10,073,589
Amortization of deferred expended capital contributions		75,959	125,351
		$8,700,596	$10,198,940

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEAR ENDED MARCH 31, 1995

	1995	1994 (Note 2)
Operating activities:		
Net cost of operations for the year	$(8,700,596)	$(10,198,940)
Non-cash transactions:		
Amortization of capital assets	129,958	125,351
Change in pension liability	27,686	(17,097)
Changes in working capital balances	96,978	298,647
	(8,445,974)	(9,792,039)
Investing activities:		
Capital assets	(569,548)	(73,119)
Financing activities:		
As shown on the statement of operations	8,700,596	10,198,940
Non-cash transaction:		
Amortization of deferred expended capital contributions	(75,959)	(125,351)
General Revenue Fund capital contributions	29,563	73,119
	8,654,200	10,146,708
Net change in due from General Revenue Fund	(361,322)	281,550
Due from General Revenue Fund at beginning of year	2,150,975	1,869,425
Due from General Revenue Fund at end of year	$ 1,789,653	$ 2,150,975

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

NOTES TO THE FINANCIAL STATEMENTS

MARCH 31, 1995

Note 1 Authority and Purpose

The Auditor General is an officer of the Legislature who operates under the authority of the Auditor General Act, Chapter A-49, Revised Statutes of Alberta 1980. The net cost of operations of the Office of the Auditor General is borne by the General Revenue Fund of the Province of Alberta. Annual operating and capital budgets are approved by the Select Standing Committee on Legislative Offices.

The Auditor General provides opinions on accountability reports, and issues an Annual Report to the Legislative Assembly containing recommendations designed to improve the financial administration of the Province. The 1993-94 Annual Report of the Auditor General was released in the 1995 fiscal year covered by these financial statements.

Note 2 Changes in Financial Statement Presentation

In previous years, financial statements of the Office of the Auditor General have consisted of a single statement of revenue and expenditure. These statements now include a balance sheet and statements of operations and changes in financial position.

Note 3 outlines the significant accounting polices and reporting practices used in the preparation of these financial statements. The major changes from previous years, all applied retroactively, are as follows:

Assets are capitalized and amortized. Previously, capital asset purchases were reported as expenditure.

Accrued vacation pay has been recorded as a liability.

A pension liability has been recorded.

Costs paid by the General Revenue Fund from other appropriations have been reported as expenses.

The cost of preparing the Auditor General's Annual Report to the Legislative Assembly is reported in the year in which the Report is issued. Costs incurred in one fiscal year pertaining to a Report to be issued in the next fiscal year are reported as work in progress.

Note 2 Changes in Financial Statement Presentation (continued)

Comparative expense figures for 1994 on the statement of operations have therefore been restated as follows:

Expenditure as previously reported	$10,526,802
Capital assets	(73,119)
Amortization of capital assets	125,351
Adjustment for accrued vacation pay	(47,164)
Change in pension liability	(17,097)
Costs paid from other appropriations:	
Office accommodation	607,399
Professional services and fees	18,550
Expenses before work in progress adjustment, as restated	$11,140,722

Note 3 Significant Accounting Policies and Reporting Practices

(a) Audit fees

Audit fee revenue is recognized when billable opinion work is done. Audit fees are charged to organizations which are funded other than by the General Revenue Fund.

(b) Work in progress

Work in progress includes the cost of billable opinion work for which invoices have not been prepared at the fiscal year end, and the cost of work on recommendations for the ensuing Annual Report. The cost of recommendation work is reflected in the statement of operations in the year in which the Annual Report is published. In this way, the cost of the output is matched with the delivery of the output.

The cost of work that is unlikely to result in recommendations is expensed in the year in which it is incurred.

(c) Capital assets

Amortization is calculated on a straight-line basis at the following rates:

Computer hardware and software	20%
Office equipment	10%

Note 3 Significant Accounting Policies and Reporting Practices (continued)

(d) Deferred expended capital contributions

Expended contributions from the General Revenue Fund for the acquisition of capital assets are deferred and amortized as the capital assets are consumed.

(e) Pension expense and liability

The cost of pension obligations earned by employees during the year, and interest on the unfunded liability which the Office has agreed to fund, are recorded as operating expenses for the year. The portion of the unfunded pension liability which the Office has agreed to fund is recorded as a liability.

(f) Supplementary performance information

These financial statements contain supplementary performance information designed to assist in evaluating the Office's performance. In management's opinion, this quantifiable information is relevant and reliable.

Note 4 Work in Progress

Work in progress consists of:

	1995	1994
Billable opinion work	$ 519,020	$ 634,423
Annual Report recommendation work	620,113	706,087
	$1,139,133	$1,340,510

Note 5 Capital Assets

	1995			1994
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Computer hardware	$ 763,004	$ 667,310	$ 95,694	$ 140,273
Computer software	675,430	158,458	516,972	29,608
Office equipment	15,971	11,947	4,024	7,219
	$1,454,405	$ 837,715	$ 616,690	$ 177,100

Note 6 Pension Liability

The Office of the Auditor General participates with other employers in the Public Service and Management Employees pension plans. These plans provide pensions for the Office's employees based on years of service and earnings.

The Office's unfunded pension liability for each plan as at March 31 was as follows:

	1995	1994
Public Service Pension Plan	$ 183,335	$ 214,192
Management Employees Pension Plan	2,107,670	2,049,127
	$2,291,005	$2,263,319

The total unfunded pension liability for each plan as at March 31, 1995 was determined by actuarial valuations, as at December 31, 1993 for the Public Service Pension Plan and as at December 31, 1994 for the Management Employees Pension Plan, both extrapolated to March 31, 1995. The 1994 comparative figures were based on extrapolations of December 31, 1991 actuarial valuations.

The Public Sector Pension Plans Act specifies the basis to determine the amount of the total unfunded liability for each plan which will be funded by employers. The Office's portion of those employers' liabilities was based on the Office's percentage of the total pensionable payroll of all employers.

Note 7 Budget

1995 Presentation

The budget shown on the statement of operations is based on the budgeted expenses approved by the Select Standing Committee on Legislative Offices on February 1, 1994. The following adjustments have been made to conform to 1995 presentation:

Note 7 Budget (continued)

1995 Presentation (continued)

Approved budget	$10,210,163
Purchase of capital assets	(85,000)
New items at actual amounts:	
Amortization of capital assets	129,958
Purchase of minor capital items	54,478
Costs paid by General Revenue Fund from other appropriations:	
Office accommodation	612,460
Professional services and fees	11,550
Budget as restated	$10,933,609

Capitalized Software Development

During the year ended March 31, 1995, the Audit Management System was redeveloped at a capital cost of $539,985. The approved budget amount shown above provided for these costs. Due to the change in financial statement presentation to capitalize and amortize capital assets, the following capitalized expenditures are not included on the statement of operations:

Salaries and wages	$325,786
Employer contributions	54,895
Computer services, contract services	159,304
	$539,985

Note 8 Lease Commitment

The Department of Public Works, Supply and Services makes lease arrangements for Office premises. Minimum rental commitments are as follows:

Fiscal	1996	$250,028
	1997	$217,654
	1998	$197,146
	1999	$197,146
	2000	$197,146

Note 9 Salaries and Benefits

Salaries and benefits are comprised of the following:

	1995				1994	
	Full-time Equivalents(1)	Salary(2)	Benefits and Allowances(3)	Total	Full-time Equivalents(1)	Total
Auditor General(4)	0.1	$ 9,175	$ 1,744	$ 10,919	1.0	$ 137,347
Senior Assistant Auditor General(4)	1.0	104,980	27,498	132,478	1.0	110,346
Assistant Auditor General, Audit Support	1.0	85,569	19,297	104,866	1.0	109,413
Assistant Auditor General(5)	1.0	85,569	19,942	105,511	1.0	107,269
Assistant Auditor General(6)	0.4	48,105	6,330	54,435	1.0	106,321
Assistant Auditor General(7)	1.0	77,259	20,296	97,555	1.0	107,810
Assistant Auditor General(8)	1.0	77,259	13,152	90,411	1.0	103,813
Directors (average* 1995 $77,819, 1994 $80,045)	24.4	1,542,950	355,840	1,898,790	26.6	2,129,188
Professional audit staff (average* 1995 $57,069, 1994 $51,397)	32.5	1,527,535	327,197	1,854,732	40.1	2,061,037
Students and other audit staff (average* 1995 $31,550, 1994 $32,349)	47.9	1,272,408	238,852	1,511,260	60.8	1,966,832
Support staff (average* 1995 $42,220, 1994 $45,426)	14.9	529,805	99,273	629,078	16.9	767,691
	125.2	$5,360,614	$1,129,421	6,490,035	151.4	7,707,067
Less:						
Decrease in accrued vacation pay and unfunded pension liabilities				(1,860)		(64,261)
Capitalization of salaries and employer contributions related to development of computer software				(380,681)		-
				$6,107,494		$7,642,806

* Average based on total

Note 9 Salaries and Benefits (continued)

(1) Presented on a weighted average basis.

(2) Salary includes regular pay and overtime.

(3) Benefits and allowances includes the Office's share of all employee benefits and contributions including health care, dental coverage, group life insurance, short and long-term disability plans, professional membership dues, and tuition.

Benefits and allowances also includes any payout of vacation entitlements. With respect to executives, the payouts were as follows:

	1995	1994
Auditor General	$ -	$21,893
Senior Assistant Auditor General	$12,244	$ 3,547
Assistant Auditor General, Audit Support	$ 5,014	$ 5,519
Assistant Auditor General(5)	$ 5,014	$ 3,449
Assistant Auditor General(6)	$ -	$ 4,057
Assistant Auditor General(7)	$ 6,036	$12,458
Assistant Auditor General(8)	$ -	$ 9,343

(4) Auditor General position vacant April 1, 1994 to February 28, 1995, during which time the Senior Assistant Auditor General assumed the duties of Acting Auditor General. For 1993-94, automobile provided to Auditor General; no amount included in benefits.

(5) Responsible for Social Services and Agriculture until August 31, 1994 and also for Education and universities with effect from September 1, 1994.

(6) Responsible for Education, universities, colleges, and Energy until August 31, 1994, at which time the position was eliminated.

(7) Responsible for Health, Transportation and Municipal Affairs until August 31, 1994 and also for colleges with effect from September 1, 1994.

(8) Responsible for Treasury until August 31, 1994 and also for Energy with effect from September 1, 1994.

Note 10 Severance Pay

Professional services and fees includes severance pay of $338,283 (1994 $71,763) determined in accordance with government guidelines.

Note 11 Approval of Financial Statements

These financial statements were approved by management.

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

SCHEDULE OF OUTPUT COSTS BY MINISTRY

FOR THE YEAR ENDED MARCH 31, 1995

	1995				1994	
	Opinion Projects	Recommendation Projects	Total	Annual Report Recommendations	Total	Annual Report Recommendatio
Work performed by Office staff:						
Treasury	$1,958,911	$ 295,789	$2,254,700	16	$ 2,613,315	17
Advanced Education and Career Development	1,244,193	215,240	1,459,433	5	1,462,662	16
Health	435,068	187,817	622,885	7	879,607	13
Municipal Affairs	395,966	148,171	544,137	4	673,530	1
Executive Council	187,002	263,725	450,727	11	175,004	7
Family and Social Services	186,955	164,397	351,352	6	485,288	16
Energy	294,715	22,296	317,011	3	454,379	6
Agriculture, Food and Rural Development	277,890	28,141	306,031	6	312,081	8
Environmental Protection	213,512	72,870	286,382	9	259,547	5
Transportation and Utilities	112,383	106,741	219,124	5	240,506	3
Education	144,260	68,021	212,281	4	210,261	3
Economic Development and Tourism	167,047	52,855	219,902	2	483,564	8
Community Development	183,509	10,020	193,529	-	222,108	1
Labour	144,021	73,601	217,622	1	313,526	-
Public Works, Supply and Services	8,714	121,493	130,207	5	19,053	-
Justice	14,590	53,879	68,469	2	294,353	4
Legislative Assembly	3,169	24,842	28,011	-	13,154	-
	5,971,905	1,909,898	7,881,803	86	9,111,938	108
Work performed by agents:						
Advanced Education and Career Development	512,445	9,000	521,445	2	642,721	-
Health	397,635	-	397,635	-	428,692	-
Agriculture, Food and Rural Development	235,568	-	235,568	-	331,237	-
Economic Development and Tourism	121,521	-	121,521	-	119,012	-
Education	81,225	-	81,225	1	91,893	-
Treasury	70,928	-	70,928	-	140,176	-
pal Affairs	69,471	-	69,471	-	228,433	-
unity Development	62,918	-	62,918	-	51,513	-
Works, Supply and Services	51,433	-	51,433	-	64,703	-
	1,603,144	9,000	1,612,144	3	2,098,380	-
	$7,575,049	$1,918,898	$9,493,947	89	$11,210,318	108

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

Schedule 2

SCHEDULE OF RECOMMENDATION WORK AND STATUS OF RECOMMENDATIONS

FOR THE YEAR ENDED MARCH 31, 1995

Focus of Work

	1993-94 Recommendation		1992-93 Recommendations	
	Primary	Secondary	Primary	Secondary
Accounting, management control and information systems and processes	13	32	22	33
Improved use of resources	7	10	11	8
Measuring and reporting the cost and effects of outputs	9	8	12	11
Compliance with authorities, and matters of probity	2	6	1	8
Other areas	1	1	1	1
	32	57	47	61

Recommendations Requiring a Formal Government Response

	1993-94 Annual Report	%	1992-93 Annual Report	%
New recommendations	27	84%	38	81%
Repeat recommendations	5	16%	9	19%
Total primary recommendations	32	100%	47	100%

Government Response to Recommendations

	December 21, 1994 (date of response)	%	March 1, 1994 (date of response)	%
Accepted	27	84%	32	68%
Accepted in principle	4	13%	12	26%
Under review	1	3%	3	6%
Rejected	-	-%	-	-%
	32	100%	47	100%

Note: The response to a primary recommendation, and any remedial action taken, is reported in the subsequent Annual Report. When the Auditor General considers that insufficient progress been made in implementing a recommendation, it will be repeated. Recommendations not repeated either have been, or are being, implemented satisfactorily. On occasion, a recommendation is neither implemented nor repeated due to changed circumstances.

ALBERTA LEGISLATURE
OFFICE OF THE AUDITOR GENERAL

SCHEDULE OF OTHER PERFORMANCE INFORMATION

FOR THE YEAR ENDED MARCH 31, 1995

Average Hourly Costs

	Auditor General		Agents*	
	1995	1994	1995	1994
Overall average	$61.17	$61.97	$72.46	$70.36

* Averages based on fees paid to agents.

Public Reporting

	1993-94 Reports	1992-93 Reports
Auditor General's Annual Report:		
Date of Report	October 14, 1994	December 31, 1993
Date released publicly	October 24, 1994	January 12, 1994
Consolidated financial statements:		
Date of Auditor's Report	June 15, 1994	August 17, 1993
Date released publicly	June 23, 1994	September 8, 1993

AUDITOR GENERAL ACT

CHAPTER A-49

Table of Contents

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Alberta, enacts as follows:

Definitions

1 In this Act,

(a) "Auditor General" means the Auditor General of Alberta;

(b) repealed 1993 c19 s17;

(c) "department" means a department as defined in section 1 of the *Financial Administration Act* and includes

(i) the Legislative Assembly Office,

(ii) the Ombudsman and the staff of the Office of the Ombudsman,

(iii) the Chief Electoral Officer and the staff of the Office of the Chief Electoral Officer and,

(iv) the Ethics Commissioner and the staff of the Office of the Ethics Commissioner;

(v) the Information and Privacy Commissioner and the staff of the Office of the Information and Privacy Commissioner;

(d) "employee of the Office of the Auditor General" includes a person engaged on a fee basis by the Auditor General;

(e) "public money" means public money as defined in the *Financial Administration Act* and includes money forming part of the Treasury Branches Deposits Fund;

(f) "regulated fund" means a regulated fund as defined in the *Financial Administration Act* and includes the Treasury Branches Deposits Fund;

(g) "Select Standing Committee" means the Select Standing Committee on Legislative Offices;

(h) "voting share" means a share of any class of shares of a corporation carrying full or limited voting rights ordinarily exercisable at meetings of shareholders of the corporation or a share of any class of shares of a corporation carrying voting rights by reason of a contingency that has occurred and is continuing.

RSA 1980 cA-49 s1;1983 cL-10.1 s57;1991 cC-22.1 s 49;1993 c19 s17;1994 cF-18.5 s93

Meaning of other words

2 Except as provided in section 1, words or expressions defined in the *Financial Administration Act* have the same meaning in this Act.

RSA 1980 cA-49 s2

Appointment of Auditor General

3(1) There shall be appointed pursuant to this Act an Auditor General who shall be an officer of the Legislature.

(2) Subject to section 6, the Lieutenant Governor in Council shall appoint the Auditor General, on the recommendation of the Assembly, for a term not exceeding 8 years.

(3) An Auditor General is eligible for reappointment under subsection (2).

RSA 1980 cA-49 s3

Resignation of Auditor General

4 The Auditor General may at any time resign his office by writing addressed to the Speaker of the Assembly or, if there is no Speaker or if the Speaker is absent from Alberta, to the Clerk of the Assembly.

RSA 1980 cA-49 s4

Suspension or removal from office

5 On the recommendation of the Assembly, the Lieutenant Governor in Council may, at any time, suspend or remove the Auditor General from office.

RSA 1980 cA-49 s5

Vacancy in office

6(1) If a vacancy in the office of the Auditor General occurs while the Legislature is in session but no recommendation is made by the Assembly before the close of that session, subsection (2) applies as if the vacancy had occurred while the Legislature was not in session.

(2) If a vacancy occurs while the Legislature is not in session, the Lieutenant Governor in Council, on the recommendation of the Select Standing Committee, may appoint an Auditor General to fill the vacancy and unless his office sooner becomes vacant, the person so appointed holds office until an Auditor General is appointed under section 3, but if an appointment under section 3 is not made within 30 days after the commencement of the next ensuing session, the appointment under this subsection lapses and there shall be deemed to be another vacancy in the office of Auditor General.

RSA 1980 cA-49 s6

Salary and benefits

7(1) The Auditor General shall be paid a salary at a rate set by the Select Standing Committee and the Select Standing Committee shall review that salary rate at least once a year.

(2) The Auditor General shall receive similar benefits as are provided to Deputy Ministers.

RSA 1980 cA-49 s7

Acting Auditor General

8(1) The Auditor General may appoint an employee of the Office of the Auditor General as Acting Auditor General.

(2) If there is neither an Auditor General nor an Acting Auditor General, the Lieutenant Governor in Council may appoint a person as Acting Auditor General to hold office until an Acting Auditor General is appointed under subsection (1).

(3) In the event of the absence or inability to act of the Auditor General, or when there is a vacancy in the office of the Auditor General, the Acting Auditor General has all the powers and shall perform the duties of the Auditor General.
RSA 1980 cA-49 s8

Office of the Auditor General

9(1) There shall be a department of the public service of Alberta called the Office of the Auditor General consisting of the Auditor General and those persons employed pursuant to the *Public Service Act* as are necessary to assist the Auditor General in carrying out his functions under this or any other Act.

(2) On the recommendations of the Auditor General, the Select Standing Committee may order that

(a) any regulation, order or directive made under the *Financial Administration Act,* or

(b) any regulation, order, directive, rule, procedure, direction, allocation, designation or other decision under the *Public Service Act,*

be inapplicable to, or be varied in respect of, the Office of the Auditor General or any particular employee or class of employees in the Office of the Auditor General.

(3) An order made under subsection (2)(a) in relation to a regulation, order or directive made under the *Financial Administration Act* operates notwithstanding that Act.

(4) The *Regulations Act* does not apply to orders made under subsection (2).

(5) The chairman of the Select Standing Committee shall lay a copy of each order made under subsection (2) before the Assembly if it is then sitting or, if it is not then sitting, within 15 days after the commencement of the next sitting.
RSA cA-49 s9;1983 cL-10.1 s57

Engagement of services on fee basis

10 The Auditor General may engage, on a fee basis, any person to act as his agent for the purpose of conducting an audit or examination that the Auditor General is empowered or required to conduct or to perform a service that the Auditor General considers necessary in order to properly exercise or perform his powers and duties.
RSA 1980 cA-49 s10

Delegation of power or duty

11(1) Subject to subsection (2), the Auditor General may delegate to an employee of the Office of the Auditor General any power or duty conferred or imposed on the Auditor General by this or any other Act.

(2) The Auditor General may not delegate a power or duty to report

(a) to the Assembly or a committee of the Assembly, without the consent of the Assembly or the committee to which the report is to be made, or

(b) to the Lieutenant Governor in Council, without the consent of the Lieutenant Governor in Council.
RSA 1980 cA-49 s11

Auditor General as auditor

12 The Auditor General

(a) is the auditor of every ministry, department, regulated fund, revolving fund and Provincial agency, and

(b) may with the approval of the Select Standing Committee be appointed by a Crown-controlled organization or any other organization or body as the auditor of that Crown-controlled organization or other organization or body.

RSA 1980 cA-49 s12;1995 cG5.5 s17

Financing of operations

13(1) The Auditor General shall submit to the Select Standing Committee in respect of each fiscal year an estimate of the sum that will be required to be provided by the Legislature to defray the several charges and expenses of the Office of the Auditor General in that fiscal year.

(2) The Select Standing Committee shall review each estimate submitted pursuant to subsection (1) and, on the completion of the review, the chairman of the Committee shall transmit the estimate to the Treasurer for presentation to the Assembly.

(3) If at any time the Legislative Assembly is not in session the Select Standing Committee, or if there is no Select Standing Committee, the Provincial Treasurer,

(a) reports that the Auditor General has certified that in the public interest, an expenditure of public money is urgently required in respect to any matter pertaining to his office, and

(b) reports that either

(i) there is no supply vote under which an expenditure with respect to that matter may be made, or

(ii) there is a supply vote under which an expenditure with respect to that matter may be made but the authority available under the supply vote is insufficient,

the Lieutenant Governor in Council may order a special warrant to be prepared to be signed by himself authorizing the expenditure of the amount estimated to be required.

(4) When the Legislative Assembly is adjourned for a period of more than 14 days then, for the purposes of subsection (3), the Assembly shall be deemed not to be in session during the period of the adjournment.

(5) When a special warrant is prepared and signed under subsection (3) on the basis of a report referred to in subsection (3)(b)(i), the authority to spend the amount of money specified in the special warrant for the purpose specified in the special warrant is deemed to be a supply vote for the purposes of the *Financial Administration Act* for the fiscal year in which the special warrant is signed.

(6) When a special warrant is prepared and signed under subsection (3) on the basis of a report referred to in subsection (3)(b)(ii), the authority to spend the amount of money specified in the special warrant is, for the purposes of the *Financial Administration Act,* added to and deemed to be part of the supply vote to which the report relates.

(7) When a special warrant has been prepared and signed pursuant to this section, the amounts authorized by it are deemed to be included in, and not to be in addition to, the amounts authorized by the Act, not being an Act for interim supply, enacted next after it for granting to Her Majesty sums of money to defray certain expenditures of the Public Service of Alberta.

RSA 1980 cA-49 s13;1983 cL-10.1 s57

Auditor General may charge fees

14 The Auditor General may charge fees for professional services rendered by his Office on a basis approved by the Select Standing Committee.

RSA 1980 cA-49 s14

Access to information

15(1) The Auditor General is entitled to access at all reasonable times to

(a) the records of a department, fund administrator or Provincial agency, and

(b) electronic data processing equipment owned or leased by a department, fund administrator or Provincial agency,

for any purpose related to the exercise or performance of his powers and duties under this or any other Act.

(2) A public employee, public official or personal service contractor shall give to the Auditor General any information, reports or explanations that the Auditor General considers necessary to enable him to exercise or perform his powers and duties under this or any other Act.

(3) The Auditor General may station in the offices of any department, fund administrator or Provincial agency, any employee of the Office of the Auditor General for the purpose of enabling the Auditor General to more effectively exercise or perform his powers and duties under this or any other Act, and the department, fund administrator or Provincial agency shall provide the necessary office accommodation for an employee so stationed.

(4) The Auditor General or an employee of the Office of the Auditor General who receives information from a person whose right to disclose that information is restricted by law, holds that information under the same restrictions respecting disclosure as governed the person from whom the information was obtained.
RSA 1980 cA-49 s15

Right to information

16(1) If the accounts of a Crown-controlled organization are audited other than by the Auditor General, the person performing the audit shall

(a) deliver to the Auditor General immediately after completing the audit a copy of the report of his findings and his recommendations to management and a copy of the audited financial statements of the Crown-controlled organization,

(b) make available immediately to the Auditor General on his request all working papers, reports, schedules and other documents in respect of the audit or in respect of any other audit of the Crown-controlled organization specified in the request, and

(c) provide immediately to the Auditor General on his request a full explanation of the work performed, tests and examinations made and the results obtained, and any other information within the knowledge of the person in respect of the Crown-controlled organization.

(2) If any information, explanation or document required to be delivered to or requested by the Auditor General under subsection (1) is not delivered, made available or provided to him or if the Auditor General is of the opinion that any information, explanation or document that is delivered, made available or provided to him pursuant to subsection (1) is not adequate to permit him to exercise or perform his powers and duties under this or any other Act, the Auditor General may make any additional examination or investigation of the records and operations of the Crown-controlled organization that he considers necessary.
RSA 1980 cA-49 s16

Reliance on auditor

16.1(1) In this section, “regional authority” means a board under the School Act or a regional health authority, subsidiary health corporation, community health council or provincial health board under the Regional Health Authorities Act.

(2) If the Auditor General is not the auditor of a regional authority, the person appointed as auditor

(a) must give the Auditor General, as soon as practicable after completing the audit of the regional authority, a copy of the person’s findings and

recommendations and a copy of the audited financial statements and all other audited information respecting the regional authority,

(b) may conduct such additional work at the direction and expense of the Auditor General as the Auditor General considers necessary, and

(c) must co-operate with the Auditor General when the Auditor General performs work for a report to the Legislative Assembly under section 19.

(3) A regional authority must give a person appointed as auditor of the regional authority any information the person requires for the purposes of subsection (2).

(4) If the Auditor General is not the auditor of a regional authority, the Auditor General may rely on the report and work of the person appointed as auditor.

1995 cG5.5 s17

Special duties of Auditor General

17(1) The Auditor General shall perform such special duties as may be specified by the Assembly.

(2) The Auditor General shall perform such special duties as may be specified by the Executive Council, but only if those special duties do not conflict with or impair the exercise or performance of any of his powers and duties under this or any other Act.

1977 c56 s17

Annual report on financial statements

18(1) After the end of each fiscal year of the Crown, the Auditor General shall report to the Assembly on the financial statements of the Crown for that fiscal year.

(2) A report of the Auditor General under subsection (1) shall

(a) include a statement as to whether, in his opinion, the financial statements present fairly the financial position, results of operations and changes in financial position of the Crown in accordance with the disclosed accounting principles,

(b) when the report contains a reservation of opinion by the Auditor General, state his reasons for that reservation and indicate the effect of any deficiency on the financial statements, and

(c) include any other comments related to his audit of the financial statements that he considers appropriate.

RSA 1980 cA-49 s18;1995 c23 s3

Annual report of Auditor General

19(1) After the end of a fiscal year of the Crown, the Auditor General shall report to the Legislative Assembly

(a) on the work of his office, and

(b) on whether, in carrying on the work of his office, he received all the information, reports and explanations he required.

(2) A report of the Auditor General under subsection (1) shall include the results of his examinations of the organizations of which he is the auditor, giving details of any reservation of opinion made in an audit report, and shall call attention to every case in which he has observed that

(a) collections of public money

(i) have not been effected as required under the various Acts and regulations, directives or orders under those Acts,

(ii) have not been fully accounted for, or

(iii) have not been properly reflected in the accounts,

(b) disbursements of public money

(i) have not been made in accordance with the authority of a supply vote, Heritage Fund vote or relevant Act,

(ii) have not complied with regulations, directives or orders applicable to those disbursements, or

(iii) have not been properly reflected in the accounts,

(c) assets acquired, administered or otherwise held have not been adequately safeguarded or accounted for,

(d) accounting systems and management control systems, including those systems designed to ensure economy and efficiency, that relate to revenue, disbursements, the preservation or use of assets or the determination of liabilities were not in existence, were inadequate or had not been complied with, or

(e) when appropriate and reasonable procedures could have been used to measure and report on the effectiveness of programs, those procedures were either not established or not being complied with,

and shall call attention to any other case that he considers should be brought to the notice of the Assembly.

(3) In a report under subsection (1), the Auditor General may

(a) comment on the financial statements of the Crown, Provincial agencies, Crown-controlled organizations or any other organization or body of which he is the auditor on any matter contained in them and on

(i) the accounting policies employed, and

(ii) whether the substance of any significant underlying financial matter that has come to his attention is adequately disclosed,

(b) include summarized information and the financial statements of an organization on which he is reporting or summaries of those financial statements, and

(c) comment on the suitability of the form of the estimates as a basis for controlling disbursements for the fiscal year under review.

(3.1) After the end of a fiscal year of the Crown, the Auditor General shall report to the Legislative Assembly on the results of the examinations of the regional authorities referred to in section 16.1.

(4) A report under this section shall be presented by the Auditor General to the chairman of the Select Standing Committee who shall lay the report before the Assembly forthwith if it is then sitting or, if it is not sitting, within 15 days after the commencement of the next sitting.

(5) The Auditor General need not report on deficiencies in systems or procedures otherwise subject to report under subsection (2)(d) or (e) which, in his opinion, have been or are being rectified.

RSA 1980 cA-49 s19; 1995 cG5.5 s17

Special reports

20(1) The Auditor General may prepare a special report to the Assembly on any matter of importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report under section 19.

(2) A report prepared pursuant to this section shall be presented to the chairman of the Select Standing Committee who shall lay the report before the Assembly forthwith if it is then sitting or, if it is not sitting, within 15 days after the commencement of the next sitting.

1977 c56 s20

Establishment of Audit Committee

21(1) There is hereby established a committee called the Audit Committee consisting of not more than 7 persons appointed as members of the Committee by the Lieutenant Governor in Council.

(2) The Lieutenant Governor in Council shall designate one of the members of the Audit Committee as chairman.

(3) The Lieutenant Governor in Council may authorize, fix and provide for the payment of remuneration and expenses to the members of the Audit Committee.

1977 c56 s21

Meetings of Audit Committee

22(1) The Audit Committee may make rules, not inconsistent with this Act, respecting the calling of, and the conduct of business at, its meetings.

(2) The chairman of the Audit Committee shall, on request of the Auditor General, call a meeting of the Audit Committee to review any matter that the Auditor General considers should be brought to the attention of the Audit Committee.

1977 c56 s22

Information re scope and results of audit

23 The Auditor General shall give to the Audit Committee any information that he considers reasonable and appropriate to enable the Audit Committee to advise the Lieutenant Governor in Council on the scope and results of the Auditor General's audit of departments, regulated funds, revolving funds, Provincial agencies and Crown-controlled organizations.

1977 c56 s23

Availability of reports

24 An annual report of the Auditor General and any special report made under section 20 shall be made available to the Audit Committee before it is presented to the chairman of the Select Standing Committee.

1977 c56 s24

When report not required

25 In a report made under this or any other Act the Auditor General need not report on matters that are, in his opinion, immaterial or insignificant.

1977 c56 s25

Supplementary information

26 The Auditor General shall, at the request of a select standing committee of the Assembly engaged in reviewing financial statements of the Crown or an organization of which he is the auditor, attend the meetings of the committee in order to give supplementary information to the committee respecting the financial statements or a report of the Auditor General.

1977 c56 s26

Audit working papers

27 Audit working papers of the Office of the Auditor General shall not be tabled in the Legislative Assembly or before a Committee of the Legislative Assembly.

1977 c56 s27

Report after examination

28 The Auditor General shall as soon as practicable advise the appropriate officers or employees of a department, Provincial agency or Crown-controlled organization of any matter discovered in his examinations that, in the opinion of the Auditor General, is material to the operation of the department, Provincial agency or Crown-controlled organization, and shall as soon as practicable advise the Treasurer of any of those matters that, in the opinion of the Auditor General, are material to the exercise or performance of the Treasurer's powers and duties.

1977 c56 s28

Advice on organization, systems, etc.

29 The Auditor General may, at the request of a department, Provincial agency or Crown-controlled organization or any other organization or body of which he is the auditor, provide advice relating to the organization, systems and proposed course of action of the department, Provincial agency or Crown-controlled or other organization or body.

1977 c56 s29

Annual audit

30(1) The Select Standing Committee shall appoint an auditor to audit the receipts and disbursements of the Office of the Auditor General.

(2) An auditor appointed under subsection (1) has the same powers and shall perform the same duties in relation to an audit of the receipts and disbursements of the Office of the Auditor General as the Auditor General has or performs in relation to an audit of the receipts and disbursements of a department.

(3) An auditor appointed under subsection (1) shall report the results of his audit annually to the Select Standing Committee.

(4) A report made under this section shall be presented to the chairman of the Select Standing Committee and to the Treasurer for inclusion in the public accounts.

1977 c56 s30

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